



BEFORE THE ARIZONA CORPORATI

IN THE MATTER OF THE) DOCKET NO.
REORGANIZATION OF UNISOURCE) E-04230A-03-0933
ENERGY CORPORATION.)

At: Tucson, Arizona

Date: June 25, 2004

Filed: JUN 28 2004

REPORTER'S TRANSCRIPT OF PROCEEDINGS

VOLUME V

(Pages 915 through 1057)

ARIZONA REPORTING SERVICE, INC.

Court Reporting

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Phoenix, Arizona 85004-1126

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1 BE IT REMEMBERED that the above-entitled and
2 numbered matter came on regularly to be heard before the
3 Arizona Corporation Commission, in Room 222 of said
4 Commission, 400 West Congress, Tucson, Arizona,
5 commencing at 9:11 a.m., on the 25th day of June, 2004.

6

7 BEFORE: WILLIAM A. MUNDELL, Commissioner
KRISTIN K. MAYES, Commissioner

8

9 JANE L. RODDA, Administrative Law Judge

10

APPEARANCES:

11

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1 APPEARANCES: (Continued)

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1 ALJ RODDA: Let's go back on the record, and
2 this is day five. It seems like longer.

3 I think we'll start this morning with
4 Mr. Reiker. Come on up and take a seat, if you can find
5 the witness stand.

6 MR. KEMPLEY: Let's not use the podium
7 today. We can trade the mike back and forth since the
8 crowd is smaller.

9 ALJ RODDA: We've worn the crowd down,
10 haven't we?

11 MR. KEMPLEY: Yes. Are we ready, Your Honor?

12 ALJ RODDA: Oh, yes.

13 MR. KEMPLEY: Okay.

14

15 JOEL MARK REIKER,
16 called as a witness on behalf of the Staff, having
17 been first duly sworn by the Certified Court Reporter,
18 was examined and testified as follows:

19

20 DIRECT EXAMINATION

21

22 Q. (BY MR. KEMPLEY) Would you please state
23 your name and business address.

24 A. My name is Joel Mark Reiker. My business
25 address is 1200 West Washington, Phoenix, Arizona.

1 Q. By whom are you employed and in what
2 capacity?

3 A. I'm employed by the Arizona Corporation
4 Commission's Utilities Division as a public utilities
5 analyst.

6 Q. And would you explain what your
7 responsibilities in this proceeding have been.

8 A. Sure. My responsibilities in this
9 proceeding included reviewing UniSource's notice of
10 intent and providing a financial analysis of the
11 immediate impact on UniSource's utility subsidiaries.

12 Q. Okay. I've had two documents premarked.
13 Premarked as Exhibit S-1 is an unredacted copy of your
14 testimony. Do you have that?

15 A. Yes.

16 Q. And S-2 is the redacted copy. Do you have
17 that also?

18 A. Yes.

19 Q. Was that testimony prepared by you or under
20 your direction?

21 A. Yes, it was.

22 Q. If I asked you the questions contained in
23 that testimony today, would your answers be the same?

24 A. Yes.

25 Q. Do you have any changes, corrections, or

1 additions to your testimony?

2 A. No, I don't.

3 MR. KEMPLEY: I move the admission of
4 Exhibits S-1 and S-2.

5 ALJ RODDA: Mr. Kempley, did you say S-1 was
6 the redacted and S-2 was the unredacted?

7 MR. KEMPLEY: I believe S-1 is unredacted.

8 ALJ RODDA: Okay. Any objections to S-1 or
9 S-2? Then we will admit them.

10 Q. (BY MR. KEMPLEY) Would you like to provide
11 a brief summary of your testimony.

12 A. Sure.

13 The proposed reorganization involves the
14 acquisition of UniSource by a private equity partnership
15 known as Saguaro Utility Group in a leveraged buyout
16 transaction. The partnership includes investment funds
17 affiliated with Kohlberg Kravis Roberts & Co.,
18 J.P. Morgan Partners, and Wachovia Capital Partners as
19 limited partners and Sage Mountain, LLC as general
20 partner. And Sage Mountain, LLC is currently owned and
21 managed by Frederick B. Rentschler, as he is the general
22 partner.

23 The partnership will acquire 100 percent of
24 UniSource's outstanding common stock through its
25 subsidiary, Saguaro Utility Group I Corp., also referred

1 to as Saguaro Holdings in my testimony, and UniSource
2 will then be a wholly-owned subsidiary of Saguaro
3 Holdings and ultimately the partnership.

4 The transaction is approximately a
5 \$3 billion transaction, including the assumption of
6 debt. It includes a 1., approximately \$1.2 billion
7 financing package that includes \$556 million of
8 partnership equity and \$660 million of debt. I can give
9 you a breakdown of what those funds will be used for.
10 Approximately \$880 million will be used to purchase the
11 common stock and options of UniSource that are currently
12 outstanding. \$263 million will be used to, will be used
13 as a cash infusion to Tucson Electric Power, and the
14 remainder will be used to cover fees and expenses
15 associated with the transaction.

16 My testimony pretty much covers what effect
17 the transaction will have on the capital structures of
18 Tucson Electric, UNS Gas, and UNS Electric. The capital
19 structures of UNS Gas and UNS Electric are not expected
20 to change as a result of the transaction. The cash
21 infusion to Tucson Electric will have the effect of
22 increasing its equity ratio as calculated for ratemaking
23 purposes by this Commission to 40 percent of
24 capitalization.

25 Other effects of that would be a slight

1 reduction in the company's cost, embedded cost of debt
2 as represented to Staff by the company as of the third
3 quarter of 2003, and that result is due to the
4 retirement of some higher cost bonds.

5 I also go into the nature of leveraged
6 buyout transactions and how the company may or may not
7 earn back a return on its premium. It's paying a
8 30 percent premium for the stock of UniSource, and I
9 also discuss the annual debt service associated with the
10 acquisition debt that will be issued.

11 Q. Does that conclude your summary?

12 A. That's pretty much what I cover in my
13 testimony.

14 MR. KEMPLEY: Thank you, Mr. Reiker.

15 Mr. Reiker is available for
16 cross-examination.

17 ALJ RODDA: Mr. Pozefsky, did you have any
18 questions for this witness?

19 MR. POZEFSKY: I have just a few questions
20 if I may, Your Honor.

21 ALJ RODDA: Please.

22

23

24

25

1 CROSS-EXAMINATION

2

3 Q. (BY MR. POZEFSKY) Mr. Reiker, you at the
4 beginning of your summary stated that the total
5 transaction would equal \$3 billion or close to that,
6 correct?

7 A. When you include the assumption of all the
8 existing debt that the consolidated entity has right
9 now.

10 Q. That is what I want to know, if you could
11 break down that \$3 billion.

12 A. Well, the 1.2 billion is you have the 550,
13 \$560 million in equity that will be contributed by the
14 partnership, and then you have the 660 million in bonds
15 that will be issued by Saguaro, and then subtract the
16 total of those two from approximately \$3 billion, and
17 that's the amount of debt that is currently outstanding.

18 Q. Then the only other question I had for you,
19 Mr. Reiker, is at the end of your summary you stated
20 that 30 percent premium may or may not be earned back.
21 Can you expand on that, explain what you meant?

22 A. Well, what I meant when I said may or may
23 not be earned back, only that there's no guarantee that
24 you're going to earn it back. When you purchase stock,
25 the stock doesn't, common equity doesn't make any

1 promises. There's no promise that anybody is going to
2 earn back the premium that they pay.

3 Q. And are you talking about down the line at
4 the exit strategy or at the point where the company
5 would be willing or be thinking about exiting? Is
6 that --

7 A. Well, either down the line when, when they
8 sell the stock, or even while they currently own it in
9 terms of receiving dividends.

10 Q. Okay.

11 A. In other words, you can earn a return
12 through dividends or capital gains or a combination of
13 both. The point I was trying to make is there's never
14 any guarantee that you're going to earn a return unless,
15 of course, you invest in a government security.

16 Q. Does that present a risk to the ratepayers?

17 A. Well, I would agree that certainly there's
18 always risks associated with investments, and to the
19 extent the investment is in a public utility that serves
20 consumers, yes.

21 Q. Okay. And if there was no premium, in other
22 words, if there was no merger, there wouldn't be that
23 risk. Is that fair to say?

24 A. No, I wouldn't agree with that, because
25 UniSource currently has investors, and they, I'm sure

1 they expect to earn a return on their investment,
2 although they're not guaranteed a return either.

3 MR. POZEFSKY: Okay. Thank you, Mr. Reiker.

4 ALJ RODDA: Mr. Heyman, did you have any
5 questions for this witness?

6 MR. HEYMAN: I do not, thank you.

7 ALJ RODDA: Commissioners, do you have?

8 COM. MUNDELL: I don't.

9

10 EXAMINATION

11

12 Q. (BY ALJ RODDA) Joel, I was just looking at
13 your JMR-8 which I think -- and you can tell me if -- do
14 you have that in front of you?

15 A. Yes.

16 Q. It shows what the capital structure is going
17 to look like pre-and post-merger, is that right? Is
18 this a consolidated --

19 A. Right. This particular schedule shows the
20 entire UniSource consolidated entity as of
21 September 30th, 2003. You would have to keep in mind,
22 though, that that's as of September 30th, 2003, and
23 whatever changes have occurred since that time, I don't
24 know if UniSource has retired debt since that time or
25 maybe even built equity up. So the actual numbers may

1 not --

2 Q. Okay.

3 A. -- may not reflect today's numbers. But if
4 you assumed that the transaction occurred on
5 September 30th, 2003, then this is what the proforma
6 would look like.

7 Q. Okay. And just looking at the total
8 long-term debt capital lease line, does that show that
9 on a consolidated basis that after the proposed merger
10 that the consolidated debt is going to go up by
11 \$400 million?

12 A. Yes, approximately 400 million.

13 Q. And I don't know if you did this, but you're
14 the witness, if you're not the Staff witness, it would
15 be Mr. Antonuk to answer this question, but perhaps you
16 are. Were you able to perform a cash flow analysis
17 about the coverage of the, post-merger of the projected
18 debt?

19 A. UniSource actually provided us with
20 confidential financial forecasts through 2012, I believe
21 it was, and they provided us statements of cash flows,
22 income statements, and balance sheets for not only the
23 consolidated entity but each of the subsidiaries,
24 including Millennium. And from those statements, we
25 were able to calculate pretty much any kind of ratio we

1 wanted to.

2 Q. And is -- I understand that some of it might
3 be confidential, but is that, is some of that analysis
4 in your testimony? Is there a schedule, if I was
5 curious on that, to look at?

6 A. Well, if you turn to -- there are two places
7 in my testimony where I kind of touch on that, and the
8 first place is page 21. It's a confidential section,
9 and it's at page 21 at lines 5 through 19, and I kind of
10 discuss the situation that was depicted in those
11 financial forecasts. And then again at page 26, I kind
12 of touch on it again when I get into what they're
13 referring to as a leverage ratio. And again, I used
14 their financial forecasts to calculate this, and it's
15 page 26, lines 12 through 21, and then again at page 27,
16 lines 1 and 2. And again, this, the discussion I
17 mentioned previously in the testimony on pages 26 and 27
18 were based on confidential financial forecasts provided
19 by UniSource.

20 Q. And briefly, I mean, I read your testimony
21 initially and just now when you mentioned it. Did you
22 perform debt service coverage ratio analysis?

23 A. We spent an extensive amount of time
24 entering a lot of the data from those forecasts into
25 spreadsheets and doing different things with it and

1 calculating a whole bunch of different kinds of ratios,
2 but as far as an actual debt service coverage ratio
3 where you take net income and divide it by principal and
4 interest payments, I am not sure if we calculated that
5 specific ratio. We could, if you wanted us to.

6 Q. Well, yesterday on the stand, I, or I don't
7 know if it was yesterday, sometime earlier, the
8 investors had indicated that there was like a 2 to 1
9 coverage, and I don't know if I'm talking what was
10 exactly a debt service coverage ratio, but we were
11 looking cash flow primarily from TEP to cover the debt
12 that would be at the holding company level. I just
13 wanted to know if you had done some --

14 A. Not that I can recall. And again, it would
15 be very simple for us to do that.

16 Q. Okay. And just in your -- I know that, I
17 don't know if you did that in connection with this
18 proceeding, but just I know you do it as a general
19 course when you're a witness in other Commission
20 proceedings when you are the cost of capital expert.
21 Did you look at, if we were doing a rate case for TEP
22 or, well, TEP, would you look at a peer group analysis
23 of what typical electric utility debt-equity ratios are?

24 A. Yes, and I actually mention that in my
25 testimony. Page 17, starting on line 10, I give a brief

1 discussion of the cost of equity in general. And we
2 didn't do any kind of cost of equity analysis for TEP
3 specifically, but I do mention that the average debt
4 ratio for comparable publicly-traded electric utilities
5 is .56 or 56 percent capitalization. Now, I was looking
6 at this this morning, and I was trying to remember if
7 that included capital lease debt, and to my
8 recollection, I don't think it does include capital
9 lease debt to the extent any of these comparables have
10 capital leases.

11 ALJ RODDA: Okay. I see.

12 All right, I don't have anything further.
13 Did you have any redirect?

14 MR. KEMPLEY: No redirect, Your Honor.

15 ALJ RODDA: Thank you, Mr. Reiker, for
16 coming down so early this morning.

17 (Witness excused.)

18 ALJ RODDA: Is there anyone on the phone?
19 There was just laughter.

20 Okay. Shall we call Mr. Pignatelli --

21 MR. HEYMAN: Please.

22 ALJ RODDA: -- to make an encore
23 performance?

24 Good morning, Mr. Pignatelli.

25 MR. PIGNATELLI: Good morning.

1 MR. HEYMAN: Your Honor, if I could, I'd
2 like to present Mr. Pignatelli here for two purposes.
3 Number one is to respond to questions from the
4 Commissioners that may not have been in attendance when
5 he was here previously, and then also to offer him up
6 for our rebuttal case. I realize we are taking this a
7 little out of step, but I wanted to allow the other
8 parties the opportunity to question Mr. Pignatelli.

9 When we offered Mr. Rentschler to come here,
10 it kind of threw everybody's schedule out a little bit.
11 So rather than have Mr. Pignatelli come back a third
12 time after Mr. Antonuk, we would be satisfied with him
13 now providing his rebuttal testimony, if that's okay
14 with you.

15 ALJ RODDA: That's okay with me.

16 COM. MUNDELL: The only problem I have with
17 that is Mr. Magruder isn't here to agree to that
18 procedure.

19 MR. HEYMAN: We did indicate to
20 Mr. Magruder that we were going to do that. The other
21 thing I would point out is it's really at our option
22 whether we call Mr. Pignatelli for rebuttal or not. So
23 if that is okay with the Commission, we will proceed
24 that way.

25

1 JAMES S. PIGNATELLI,
2 called as a witness on behalf of the Applicant, having
3 been previously duly sworn by the Certified Court
4 Reporter, was examined and testified as follows:

5

6 DIRECT EXAMINATION (REBUTTAL)

7

8 Q. (BY MR. HEYMAN) What I would like to do
9 first, Mr. Pignatelli, is have you address a couple
10 matters that have come up during the course of this
11 proceeding. Some of them that have come up are tax
12 related, so I want to lay a little bit of foundation for
13 your ability to testify regarding matters that involve
14 computation of taxes. Could you please explain for us
15 what prior experience you have had regarding calculation
16 of taxes and the involvement of taxes in the utility
17 industry.

18 A. My education was first as an accountant
19 before I went to law school, and I passed the California
20 CPA exam as well as the California Bar. My first job
21 actually was while I was going to school, and I
22 established the tax records, property tax records for
23 San Diego Gas and Electric Company.

24 When I left San Diego Gas and Electric
25 Company, I was hired as manager of taxes at Southern

1 California Edison. In both of those jobs, I testified
2 on tax matters before the California Public Utilities
3 Commission and the Federal Energy Regulatory Commission.
4 Somebody actually put something on my desk today that I
5 had forgotten about. In 1977, I presented a paper to
6 the American Gas Association in Edison Electric
7 Institute on the regulatory treatment of tax benefits of
8 nonutility operations which also covered normalization.
9 And I testified and worked with the Department of
10 Treasury on normalization regulations relative to tax
11 timing differences on utility properties, somewhat
12 referred to as Section 167(L) and 162(F)(23), as I
13 recall. But those have been changed I'm sure in the tax
14 code by now.

15 Q. Thank you.

16 You were previously asked some questions
17 about what effect, if any, the merger transaction would
18 have on the payment of state property and income taxes.
19 And for the record, I would like to note that
20 conversation took place on pages 367 to 372 of the
21 transcript, but could you please provide us with an
22 explanation at this time of what effect the merger
23 transaction will have on the payment of state property
24 and income taxes.

25 A. Okay. The structure of this transaction

1 results first in no change in the way income, expenses,
2 and property is treated for tax purposes in either the
3 State of Arizona or under the federal codes. So let's
4 go first to property taxes. This state assesses utility
5 property based on cost. This transaction involves the
6 sale not of the assets, but the sale of stock. So there
7 should be no change in the tax on property, on the
8 property taxes if we do not assume any change in tax
9 rate.

10 With respect to sales tax, there is no
11 change with respect to sales tax or local utility taxes.
12 With respect to state income taxes and federal income
13 taxes, as I testified before, all other things being
14 held constant, the only thing that changes, and I cited
15 them last time, was tax deductions resulting from losses
16 at Millennium because that company is no longer in a
17 loss situation. When I testified before, and it was
18 left out of the testimony, I estimated those at about
19 10 million. Last year, we lost 25 million at
20 Millennium. So think of an increase in taxes, taxable
21 income by 25 million.

22 We have net debt of 400 million as a result
23 of the transaction, a net debt increase of 400 million.
24 And if I assume an 8 percent interest rate, that would
25 mean there was an increase in interest of \$32 million.

1 So I have increased income by 32 million because I've
2 decreased income by 32 million because of higher
3 interest on 400 million. I have decreased, increased
4 taxable income by 25 million because of no more losses
5 at Millennium.

6 We also have refinanced 400 million worth of
7 tax exempt floaters at a benefit of about 200 basis
8 points. 200 basis points on 400 million is about
9 \$8 million in less tax, in less interest paid. So I
10 have 32 million more interest, I have 25 million less
11 deduction, and I have 8 million less deduction. That
12 means that, 25 and 8 is 33, and so I have an increase in
13 taxable income of 33, and a decrease of taxable income
14 of 32 million or a \$1 million differential in taxable
15 income as a result of these three discrete items.
16 Nothing related to the merger other than change in the
17 interest expense, the total interest expense and this
18 Millennium. So based on those numbers, it's basically a
19 wash.

20 I testified earlier and had underestimated
21 the loss at Millennium which is going away, and in that
22 example I gave, I believe that I said there would be a
23 slight tax reduction. But looking at the numbers, it is
24 just about a wash.

25 The other thing I would like for the record

1 and for the Commission to know is that our effective tax
2 rate, income tax rate in Arizona is 6.5 percent. Our
3 effective federal tax rate is 32.5 percent. So if they
4 hypothecate different numbers, they have now the tax
5 rates to apply to determine what the impact is.

6 Q. Thank you, Mr. Pignatelli.

7 Would your analysis with regard to federal
8 income taxes be the same?

9 A. Yes. It's just a higher rate, the 32.5 rate
10 applied to the differential in taxable income versus the
11 6.5 state rate applied to taxable income. And when I
12 say it's effective, because the statutory rates are a
13 little bit higher, but you get deductions on other tax
14 returns for taxes paid in different jurisdictions.

15 ALJ RODDA: Just so I'm clear, because you
16 pay the taxes at a consolidated level, all these numbers
17 were at the consolidated UniSource level.

18 THE WITNESS: No, these are the statutory
19 rates.

20 ALJ RODDA: No, I mean the dollar amounts
21 you were estimating.

22 THE WITNESS: Yes, yes. You're correct on
23 that. There's been a longstanding policy of this
24 Commission that you calculate taxes for ratemaking on a
25 stand-alone basis. It goes back into probably the

1 eighties when the first forays into unregulated and
2 consolidated income statements, and that is included,
3 that concept is included in our cost allocation manuals
4 which were re-adopted in the holding company case. So
5 in calculating taxes, you calculate the tax for rate
6 purposes on the revenue and expenses of the regulated
7 entity and do not include any expenses of the
8 unregulated entities, and that's the, in my opinion, the
9 proper thing to do, because it, there are various
10 reasons for that, very positive reasons.

11 Q. Mr. Pignatelli, Commissioner Mundell has
12 asked us some questions about the Portland General
13 Electric case in Oregon. Are you familiar with that?

14 A. Yes, sir.

15 MR. HEYMAN: Your Honor, what I would like
16 to to is have marked as Exhibit A-9 a letter dated
17 June 4th, 2004, and it is actually from the Circuit
18 Court of Oregon, Third Judicial District, and it is
19 relating to the case Utility Reform Project Versus
20 Public Utility Commission of Oregon, Marion County
21 Circuit Case Number 03C21227. I will be asking
22 Mr. Pignatelli questions regarding this.

23 Q. (BY MR. HEYMAN) Mr. Pignatelli, do you have
24 in front of you the document that has been marked as
25 Exhibit A-9?

1 A. Yes, I do.

2 Q. And could you please explain for the record
3 what this letter is.

4 A. This letter is a summary of the Circuit
5 Court of Oregon's in the Third Judicial District
6 decision relative to a request for remand of the Oregon
7 Public Utility Commission's decision covering the
8 treatment of Portland General Electric's taxes on a
9 stand-alone basis when it was consolidated on the Enron
10 consolidated basis, and whether, two issues, whether the
11 ratepayers, the customers of Portland General had paid
12 too much, and whether it was a fraudulent issue on
13 taxes.

14 Q. And do you see at the last page of this
15 document that it was signed by the judge, is that
16 correct?

17 A. Yes.

18 Q. Could you please tell us what your
19 understanding is of the relevance of this decision of
20 the judge to the stand-alone taxation question that has
21 been raised here?

22 A. This judge actually reaffirmed the position
23 of the Oregon Public Utility Commission that stand-alone
24 taxation is the appropriate way for ratemaking purposes.
25 If I might read, it states that, "For the period that

1 PG&E," Portland General Electric, "was wholly owned by
2 Enron, PG&E was treated for ratemaking purposes as a
3 stand-alone entity, and thus, the actual taxes paid by
4 the tax connected third-party entity is not relevant."

5 It stands for the proposition that
6 stand-alone taxation of utilities and treating it on a
7 stand-alone basis in, for regulatory purposes is the
8 appropriate standard in Oregon, and it has been the
9 standard that we have followed in this state for as long
10 as I know. And it is the standard that is followed in
11 most regulatory venues, and is cited as the preferable
12 regulatory methodology.

13 Q. Mr. Pignatelli, I guess the core question
14 here is are the issues that are of concern in Oregon
15 matters of concern here in Arizona in this proceeding.

16 A. No, not at all. The situation on the Enron
17 is that PG&E was taken into a very large tax return, and
18 Enron had allegedly, I have to watch my words, allegedly
19 been fraudulent in other venues in the amount of tax
20 which should be paid by those, or should not be paid by
21 those venues. And when you consolidated all of that,
22 PG&E was just one part of a much larger consolidated
23 income tax return where there might have been other
24 issues. They were not issues with regard to PG&E's
25 taxes.

1 In our case, we're not merging with -- I
2 wish we had never referred to this as a merger. We're
3 not merging with any operating entity which has other
4 entities in it. The tax return to be filed by this
5 organization after hopefully this is approved is exactly
6 the same tax return that we file now. We still have the
7 same unregulated entities, we still have the same
8 regulated entities. We're not bringing any structural
9 difference, we're not bringing any new entities into the
10 consolidated tax return. So it's a completely different
11 issue, but it does stand for the proposition that the
12 appropriate ratemaking is to treat the utility for
13 ratemaking purposes on a stand-alone basis.

14 Q. Thank you.

15 MR. HEYMAN: I move for admission of
16 Exhibit A-9.

17 ALJ RODDA: Okay. Any objection to A-9?

18 MR. POZEFSKY: None.

19 ALJ RODDA: We'll admit A-9.

20 Q. (BY MR. HEYMAN) Mr. Pignatelli, would you
21 please now turn to the exhibit that has been marked and
22 admitted as RUCO-5. Do you have that in front of you?

23 A. Yes, I do.

24 Q. RUCO-5 has been identified as testimony and
25 transcript that was part of the, what we've been calling

1 Citizens acquisition case. You testified in that
2 proceeding, is that correct?

3 A. I did some testimony. This is not any of my
4 testimony, but yes.

5 Q. Correct. This is the testimony of
6 Mr. Larson, a UniSource --

7 A. Correct.

8 Q. And he is UniSource Energy's CFO, is that
9 correct?

10 A. That's correct.

11 Q. And you were previously aware of
12 Mr. Larson's testimony, is that correct?

13 A. Yes.

14 Q. And have you had an opportunity to review
15 the exhibit that's been marked as RUCO-5?

16 A. Yes.

17 Q. Mr. Pignatelli, is there anything
18 inconsistent with Mr. Larson's description of the
19 financial condition of UniSource Energy with what has
20 been described in this case will be the financial
21 condition absent the merger?

22 A. No, there's nothing, nothing inconsistent.
23 The only thing, we're at a later point in time where
24 there are currently more risks than were in that
25 particular time, or risks, I don't know whether more

1 might be an inappropriate description, but let me give
2 you an example.

3 We use about 20 million Mmbtu a year of gas
4 between TEP and UES, about ten in each company, so that
5 a \$1 change in the price of gas results in \$20 million
6 change in our cost of fuel or cost of product. In the
7 UniSource Gas side, depending on how long a period we
8 collect, can collect that dollar increase puts us,
9 because of the volatility in the gas market, we have a
10 need for increasing liquidity, liquidity over what, at
11 that point in time Mr. Larson said, just because of what
12 is happening in the gas market. Likewise, at TEP, the
13 Settlement Agreement, when that was entered into, the
14 cost of gas, it was about \$2.50 an Mmbtu. The cost of
15 gas today is 6 or \$7 an Mmbtu. So you can see there are
16 many more pressures just because of that aspect in our
17 total liquidity and our total flexibility with regard to
18 financing and financing options. But at the time this
19 was put in, this is entirely accurate, entirely
20 represents what the company was doing and what the
21 company was thinking.

22 Q. Mr. Pignatelli, you were here yesterday and
23 listened to Mr. Goldstone talk about outages in UES'
24 service territory, is that correct?

25 A. Yes.

1 Q. Could you please explain your understanding
2 of the situation with regard to service by UES that
3 exists now, especially in the Bullhead City area?

4 A. Yes. Since we acquired Citizens, we have
5 put an additional about 50 to \$60 million into plant to
6 serve additional customers as well as to provide for
7 better reliability, and I might say that this plant is
8 not included in rate base.

9 ALJ RODDA: Mr. Goldstone?

10 MR. GOLDSTONE: Yes, this is Marc Goldstone.

11 COM. MUNDELL: Yes, we're in the middle of
12 the hearing, so just listen.

13 ALJ RODDA: Mr. Goldstone?

14 MR. GOLDSTONE: Yes.

15 ALJ RODDA: Whatever you have in the
16 background, you have to keep it down, okay?

17 MR. GOLDSTONE: Okay.

18 ALJ RODDA: I'm sorry; go ahead.

19 THE WITNESS: So we have added about 50 to
20 60 million in plant investment. And I don't have a
21 breakdown of how much of that was for system
22 reinforcement versus system corrections. I can tell you
23 that we have increased the frequency of our system
24 patrols, and I think Mr. Goldstone might have referenced
25 that yesterday. We have reset line recloser trip

1 settings, we are inspecting our automatic line reclosers
2 monthly versus quarterly as Citizens did it. We have
3 replaced fuses with automatic reclosers.

4 Our records show that there have been this
5 year two outages on the Mohave system. Both of them
6 were on the WAPA system; they were not on UES. We take
7 the power to supply Bullhead City and others over
8 Western Area Power Authority lines, and then we put that
9 over our subtransmission and distribution facilities.
10 The two outages were on that system, not ours. Those
11 are my records.

12 Now, that sounds like that's a tremendous
13 improvement, but I must caveat that it hasn't, we
14 haven't had storm season, and the vast majority of the
15 outages come in storm season. I can't predict where
16 lightning is going to strike or where the wind is going
17 to blow the hardest. We try to keep the insulators
18 clean. If it rains, you can have shortages on
19 insulators and have outages.

20 In addition, we can have outages caused by
21 birds. We have increased the bird guarding. Two
22 reasons, I get a lot of pressure for, community pressure
23 when there is a Harris hawk or something that's
24 unfortunately electrocuted itself, and we do as much as
25 possible in putting bird guarding on. We've commenced a

1 bird guarding program in Mohave County that did not
2 exist under Citizens. We've done that in Santa Cruz
3 County also. I've added two additional crews, we've
4 upgraded equipment, and I cited some of this before.

5 We upgraded equipment for faster response,
6 and we have combined our material standards, and this is
7 important, because we now have the same material
8 standards between UES Electric and TEP. So that
9 provides that we can have better response because
10 frankly, we can carry an inventory at TEP and it's
11 available. There was never an inventory, or there was
12 an insufficient inventory available for UES when we
13 acquired these properties for those properties. By
14 combining material standards, we are better able to
15 serve the customer.

16 There are a myriad of other things. I hope
17 that we don't have a big storm season and I can come
18 back and say, "We only had two outages, and we weren't
19 the fault." I'm sure we'll have more outages. All we
20 can do is be there, have a quick response, and try to
21 correct it as quickly as possible.

22 We generally look at a couple measures. One
23 is the average length of time a customer is out without
24 power. And in the western United States, the average
25 when there is an occurrence that a customer is out of

1 power is 86 minutes. Ours is 77 minutes at TEP. UES
2 was about 88 minutes under Citizens, 86 versus 88, ours
3 about 77 at TEP.

4 The other thing we measure is sustained
5 outages, how many the average customer, how many times
6 does he have a sustained outage. In the western United
7 States, it's about 1.06 times a year. At TEP, it's
8 about 1.08 times a year. Now, the only information I
9 have on UES is this year, and I just don't think it's
10 relevant because we haven't had a storm season, but I
11 can tell you it's way less than 1 percent or 1 time.

12 We're doing everything we can. I just wish
13 that these customers would give us the same opportunity
14 that I think is being accorded to us in Santa Cruz
15 County. And you've heard the reaction of Santa Cruz
16 people, Ignacio Barraza, I'm sorry if I mispronounced
17 his name, they have been working well with us. It's a
18 little easier for us because we're following the
19 Commission's admonition carefully to try to integrate
20 more and more with TEP in the Santa Cruz County. It's a
21 little harder to do that in Mohave at this point in
22 time, but we're trying to instill the same regard for
23 customer needs and reliability of service and to give
24 those employees in Mohave County the same tools that we
25 have available here.

1 Q. Mr. Pignatelli, you mentioned that monsoon
2 season is coming upon us. Has UES increased its
3 inspection crews of the lines in anticipation of a
4 monsoon season?

5 A. Yes, as I indicated, we've increased our
6 inspection on the lines and we've increased testing
7 reclosers. It's much what we do here. Before storm
8 season in Tucson, actually, before the heat buildup, we
9 infrared all of our underground in the City of Tucson to
10 see if there are flaws or cable is getting worn such
11 that we know when it gets hot, the demand, the
12 through-put on the system goes up. That means those
13 circuits heat up, not only just from the ambient air
14 temperature but from the velocity of current moving
15 through them they'll heat up. So we go out and every
16 year, we infrared the system in downtown Tucson so that
17 hopefully we don't lose buildings during, when the air
18 conditioning is needed.

19 That's an example of just what is normal
20 practice for us, and we have increased and tried to
21 bring that normal practice, that anticipation looking
22 for things that might fail, that's what we're doing in
23 Mohave County right now. And I'm pleased to hear that
24 he's seen three trucks in the area recently. I'll tell
25 you, they were there before yesterday, they've been out

1 more and more.

2 Q. Okay. Final area, Mr. Pignatelli, have you
3 had a chance to review the testimony and witness summary
4 of Mr. Antonuk?

5 A. Yes.

6 Q. And with reference to Mr. Antonuk's witness
7 summary, he indicates two areas where there's still some
8 work to be done between Staff and the company as far as
9 being together, and that involves adequate financial
10 conditions and the language regarding nonutility
11 investments. Do you have any comments that you would
12 like to offer the Commission about the application of
13 conditions along those lines to you as the manager and
14 operator of UniSource and its utilities?

15 A. Yes. We've worked very well with the Staff,
16 and I think that both of us have come a long ways in
17 providing, maybe I want to say preserving and meeting
18 the lack of harm, in providing benefits, and actually in
19 providing current benefits to all constituents. And
20 we're just apart on a couple items, and one of them is
21 the requirement or the condition that the Staff wants us
22 to pre-retire \$500 million worth of debt versus
23 \$400 million worth of debt. The pre-retirement of
24 \$400 million worth of debt brings us to an equity ratio
25 of someplace between in 2008 of someplace between 42 and

1 44 percent. We're moving above the 40 percent. We
2 don't have an issue with that. We're trying. Staff
3 would like us to go to 500, and that would bring us more
4 probably in the line of 44 to 45 percent equity ratio.

5 What I have difficulty with is it, and as I
6 said before when I testified, it, I need flexibility.
7 Yes, we generate cash flow. Yes, if we took all that
8 and we pre-retired debt, we could achieve 500. We could
9 probably maybe even achieve a little more. But I don't
10 have the flexibility. And as I said, right now, with
11 gas prices at \$7 and every Mmbtu of gas that we burn,
12 every dollar change is \$20 million that I have to
13 somehow accommodate for some period of time. If it's
14 TEP, it's 10 million that I have to accommodate forever
15 at this point in time, because there is no adjustment in
16 rates for what, in TEP rates for what I spend on gas.

17 Additionally, as we've talked, we need
18 generation. Where am I going to get generation? Am I
19 going to buy it in the marketplace? As I indicated, my
20 philosophy is I think we should have at least 75 percent
21 of our total needs under our control in some fashion,
22 and I've talked with the Commission about how we move
23 Citizens, the old Citizens property from 100 percent
24 requirement on the open market to some stability in
25 electricity. And with that regard, we are in the market

1 every day looking at potential acquisition of
2 generation, and the Staff's conditions vis-a-vis their
3 request vis-a-vis the additional pay down of debt just
4 leaves me with too little liquidity. And the condition
5 relative to nonregulated assets in the approval, I don't
6 know where generation is going to be. I just know that
7 every day, we're looking at should we acquire
8 generation, and we are under discussion on two or three
9 opportunities, and if they flesh out, and they could
10 flesh out next week, they could flesh out next month,
11 they could flesh out next year. I would come to this
12 Commission and say, "What do you want us to do with
13 this? This is in the best interest of Arizona, it's in
14 the best interest of my consumer, it's in the best
15 interest of all consumers. How do you want us to treat
16 this?" But if I don't have any liquidity flexibility, I
17 can't even bring that choice to the Commission, and I
18 tell you I need that. I need that opportunity to
19 protect the ratepayer.

20 MR. HEYMAN: Thank you.

21 Your Honor, I have no further rebuttal
22 questions of Mr. Pignatelli. I appreciate everyone's
23 indulgence, and we would tender him for questions by the
24 Commission and cross-examination by the other parties
25 here.

1 ALJ RODDA: I'm sort of torn -- I guess I'll
2 ask Mr. Pozefsky, I was going to let the Commissioners
3 go first because last time you had recross on Commission
4 questions. But I think we'll start with you,
5 Mr. Pozefsky.

6 MR. POZEFSKY: Okay.

7

8 CROSS-EXAMINATION

9

10 Q. (BY MR. POZEFSKY) Good morning,
11 Mr. Pignatelli.

12 A. Good morning.

13 ALJ RODDA: Can you use the microphone? I
14 don't know if Mr. Goldstone is still on the phone, but
15 it might be easier for him to hear.

16 Q. (BY MR. POZEFSKY) Mr. Pignatelli, I just
17 want to follow up on the last comment you made about
18 your relationship with Staff, and I'll refer to the
19 surrebuttal testimony of John Antonuk. On the last
20 page, his recommendation, he is referring to Staff's
21 conditions, he says, "Even if these conditions and
22 changes are adopted, in the absence of comparable
23 benefits to customers, Staff at best would be neutral
24 with regard to approval of this transaction." You're
25 not suggesting that Staff's position has changed, are

1 you?

2 A. What I am saying is we have worked well with
3 the Staff to get to the condition of neutrality. I
4 disagree on benefits with the Staff perhaps. I don't
5 know how the Staff really feels about the benefits. I
6 believe that we have demonstrated benefits to all
7 parties, and I believe that we have demonstrated current
8 benefits to all parties.

9 In my opinion -- and it's an interesting
10 dichotomy perhaps, because it's really representing who
11 you represent. I differ with others perhaps that the
12 most important thing to the consumer is that bill. I
13 think the most important thing to that consumer is when
14 they hit that light switch, that light goes on. I think
15 the most important thing to the consumer is that they
16 have electricity so that their kids can learn on the
17 Internet. I think the most important thing to the
18 consumer is that they have space conditioning which is
19 essential to their way of life.

20 I think very important to the consumer is
21 stability; it's not instantaneous gratification. They
22 get that because their ice cream is cold and their beer
23 is cold when they come home. It's stability in prices.
24 We provide a commodity that we understand is essential,
25 and it is reliability and the ability of that consumer

1 to depend upon that that is most important.

2 The second thing is stability in long-term
3 pricing. The consumer can plan for stability. They
4 can't plan for fluctuations, and that is why this
5 proposal in my opinion meets the consumers' needs and
6 meets their immediate need for benefit.

7 Q. If they can't pay the bill, the switch
8 doesn't come on, does it?

9 A. Sir, we have many programs to help those
10 that can't pay the bill. I can guarantee you that.

11 Q. Okay. I'd like to ask you some questions on
12 the taxes, Mr. Pignatelli. You state that for
13 ratemaking principles, purposes, taxes should be
14 calculated on a stand-alone basis. We're talking about
15 income taxes, correct?

16 A. That's correct.

17 Q. As far as how they're paid, though, they're
18 actually paid on a consolidated basis, isn't that
19 correct?

20 A. That's correct.

21 Q. And looking at that chart, I'm trying to
22 determine which entity there would be the one that would
23 be paying for the or the consolidated entity that would
24 be paying the bill. Would that be the UniSource Energy
25 Corporation?

1 A. Yes, it would be the merged UniSource Energy
2 Corporation will pay the bill.

3 Q. And you're not stating that the Commission
4 has established a policy that income taxes should be
5 calculated on a stand-alone basis, are you?

6 A. Yes, I am stating that. It's a long-term
7 policy that they've applied to us. It's been
8 incorporated in many of our decisions.

9 Q. Okay.

10 ALJ RODDA: Mr. Pignatelli, are you sure
11 that it's UniSource that is going to be paying the bill?

12 THE WITNESS: Actually, I was thinking about
13 that. There's debt held at the company above, so we
14 probably will file that at the Saguaro Utility Group I
15 Corp. I can't read that far away.

16 ALJ RODDA: It's hard to read, but yes, I
17 think it's the corporation.

18 THE WITNESS: Pardon me?

19 ALJ RODDA: You are referring to the
20 corporation above the UniSource Corporation?

21 THE WITNESS: Yes.

22 COM. MAYES: Could I just jump in real
23 quick?

24 To Mr. Pozefsky's point, Mr. Pignatelli, the
25 Commission has never had opportunity to address a

1 situation like this, so we could not possibly have
2 formulated a policy about taxation relative to a utility
3 that was owned by a holding company, correct? I mean,
4 I know you're saying that's not the way it will happen,
5 but we have never seen anything like this, so we don't
6 have any policy like this --

7 THE WITNESS: Well --

8 COM. MAYES: -- or about this.

9 THE WITNESS: I would beg to differ on that.
10 You have Pinnacle West, you actually have UniSource
11 where UniSource has spent over the last five years
12 \$65 million in Global Solar and incurred \$65 million in
13 losses, even though the benefit is really intended for
14 meeting TEP's needs to be responsible, responsive
15 citizen in environmental matters. That \$65 million has
16 been borne by the shareholder, and the shareholder
17 essentially got a little bit of benefit because they
18 retained that tax benefit. So you do have similar
19 situations. I'm not going to say it's exactly the same,
20 but I think they're certainly close to being on all
21 fours.

22 COM. MAYES: Okay.

23 Q. (BY MR. POZEFSKY) Mr. Pignatelli, the
24 reason I asked about the policy, and I still think there
25 is a point here. And just so I'm clear, I vaguely

1 recall that the Commission has considered the income tax
2 question on a consolidated basis in other utility areas.
3 Now, I may be wrong, but I know it's a consideration in
4 some water cases. So just so I'm clear, you're saying
5 that it's always been applied to UniSource, but you're
6 not speaking, for example, its applications on other
7 utilities, or are you?

8 A. That's correct, I'm not, other than I think
9 it's the right policy.

10 Q. Okay. Thank you.

11 I wanted to go to the direct testimony of
12 Mr. Larson, RUCO's Exhibit No. 5 if I may. And if we
13 could go to page 13, on line 17 or 18, it says there
14 that the loan of \$50 million would not affect TEP's
15 stated objective of continuing --

16 A. Could you wait just a minute? I'm trying
17 to find the cite. You're at --

18 ALJ RODDA: Interestingly enough, page 13 is
19 like the second page of the exhibit.

20 MR. POZEFSKY: Yes, and the third page of
21 the fax.

22 THE WITNESS: Okay. I have it now. Thank
23 you.

24 Q. (BY MR. POZEFSKY) If you go to lines 17 and
25 18, you'll see it says, "Based on current forecasts of

1 TEP's cash," this is in answer to a question, "and
2 liquidity, a loan of \$50 million would not affect TEP's
3 stated objective of continuing to approve its equity
4 ratio including using 30 million to \$50 million per year
5 for early debt retirements and lease debt purchases."

6 My question is TEP's current objective, of
7 course, is to continue to improve its equity ratio, is
8 that correct?

9 A. That's correct.

10 Q. And if the merger is not approved, TEP's
11 objective would still be to continue to improve its
12 equity ratio, is that correct?

13 A. That's correct. We'd just start about
14 \$270 million behind.

15 Q. Now, the \$50 million loan, that is part of
16 the \$95 million loan that will be paid off if this
17 merger is approved, is that right?

18 A. There was never a \$50 million loan made, and
19 it's not part of the 95 million.

20 Q. Okay. Well, maybe you could tell me,
21 because I believe somewhere else in here I saw that
22 Mr. Larson was talking about how the \$50 million would
23 be used by UniSource as part of the funds to pay for the
24 access of Citizens. Was the 50 million used -- well,
25 you are not saying there ever was a 50 million?

1 A. I can make it a little clearer maybe.

2 At the time of the Order, we did not have
3 the equity necessary to acquire Citizens, and we needed
4 flexibility. We knew that we had money coming to us as
5 soon as we closed Springerville, \$35 million due us. So
6 we wanted some protection that we could make a timely
7 closing because it meant \$10 million in benefit to the
8 consumer if we could make a timely closing and acquire
9 those properties for \$10 million less. So we wanted to
10 make sure that we could, we would have the equity
11 necessary to close it, and that's why this is here. It
12 was always intended to be no more than a bridge loan,
13 even though the terms discussed of ten years, et cetera.

14 What actually happened is we went out and
15 got a bridge loan from a bank for \$35 million, we paid
16 it off the next month, and we never drew on this
17 \$50 million. But it's important that this is here
18 because as I said, we're getting, we get stressed at
19 UniSource Gas because of buying 10 million Mmbtu a year,
20 and with the cost at 6 or \$7, we get stressed because
21 that's not in the amount that's collected in current
22 rates. We have build-up at that level, \$7 million, we
23 do have build-up in our purchased gas adjustment.

24 And we need that liquidity. We have the
25 liquidity still here; we have not used it. But I have

1 discussed this point with the Commission in other
2 proceedings that we have to be very careful, and that's
3 another benefit of this transaction is we're going to
4 get \$40 million worth of line, revolving line for five
5 years at UES which will give us better liquidity to
6 withstand aberrations in the gas markets and in other
7 markets. But we have not drawn on this 50.

8 Q. Okay. Is the 50 million still available if
9 you needed it?

10 A. Depends on what time of the year, because at
11 this point in time, our cash balances would be low at
12 TEP. We've just paid lease payments. They will build
13 through the end of the year. We still have our revolver
14 that we can draw on, that TEP can draw on the 50 million
15 revolver that it has. But in addition to the 40 million
16 revolver at UES, there is going to be another revolver
17 at UniSource which gives us more liquidity in these
18 operations. But for the most part, yes, we could, TEP
19 could come up with the money to pay, to loan.

20 In addition, though, I think the question by
21 the Judge this morning, we continue to pre-retire. The
22 numbers she was referring to Mr. Reiker were the
23 September basis. We have had some income and we have
24 probably retired another, oh, 20, 30 million in debt
25 since that. We made lease payments in February, I

1 believe, so that reduced some of our debt. We, our cash
2 flow is well managed, and it goes up and down and is
3 very seasonal. We have property taxes which are big at
4 certain times, we have lease payments which are large at
5 certain times of the year, but in general, we have
6 liquidity at TEP.

7 Q. What was the \$95 million used for?

8 A. The 95, actually, that's an interesting
9 thing. We established subsidiaries at TEP that were
10 doing Global Solar or like ventures, and we had put
11 about 70 million into it. In the holding company, we
12 transferred those assets out and created a \$95 million
13 note, a note that really has a basis at TEP of 70, but
14 it's 95 million, and we paid interest on that note I
15 believe equal to TEP's cost of capital. It was purely a
16 transfer of assets out. When that note's paid off, our
17 actual equity at TEP goes up \$25 million because it's
18 only on TEP's books for 70, but it's going to be paid
19 off at 95. But that's the history of that note.

20 Q. And was that note approved by the
21 Commission?

22 A. That was all in our holding company, yes.
23 The rate -- and it's not an advancement of money. This
24 was taking assets that were nonutility and moving them
25 out, and that 95 represents every cent that went into

1 those, even if that cent had been written off. That's
2 the difference between the 70 and the 95. We put every
3 cent that was ever put by TEP into any entity that was
4 moved outside of TEP under the holding company, and
5 that's what that note was set up. And we paid interest
6 equal to TEP's cost of capital.

7 Q. So the company did explain this to the
8 Commission, that this is how this would work?

9 A. Yes.

10 Q. Okay.

11 Now, at the time Mr. Pignatelli --
12 Mr. Larson says that a loan of that sort -- now, of
13 course, you didn't take out that loan, but a loan of
14 that sort of \$50 million would not impair TEP's
15 financial status or its ability to raise additional
16 capital. Is that correct, at least at that time?

17 A. Where is that?

18 Q. It's on the bottom of page 13.

19 A. Okay. That's correct.

20 Q. Such a loan I believe Mr. Larson also says
21 would not affect TEP's ability to meet its public
22 service obligation, is that correct? I can refer you
23 to that. It's on page 1 of the supplemental testimony.
24 In fact, if you go down to line 22, it said that at
25 least at that time, a \$50 million loan would not impair

1 TEP's financial status, its ability to attract capital,
2 or its ability to meet its public service obligations,
3 is that right?

4 A. I'm sorry, where is that?

5 Q. Page 1 of Kevin Larson's supplemental
6 testimony.

7 COM. MUNDELL: On the top it says page 5.
8 The fax says page 5 on the top.

9 Q. (BY MR. POZEFSKY) I think it's actually the
10 fourth page of the exhibit in --

11 A. Okay.

12 Q. -- and it says --

13 A. Line 22?

14 Q. Yes, line 22 and 23.

15 A. Yes, I see that, and it's what he so stated.

16 Q. Okay. And from that I would take,
17 Mr. Pignatelli, at least at that time, TEP's financial
18 condition was pretty good, correct?

19 A. I think that overstates it. I think that we
20 had cash flow that was available which we could meet our
21 construction needs. We had cash flow over that that was
22 available so that we could meet our planned debt
23 retirements, and we had cash flow over that we could do
24 30 to 50 million a year in pre-retirement. Does that
25 make the company financially a star? No. It meant

1 that we were a double B credit.

2 Q. Has anything happened in that time, from
3 that time to the present time, that would impair or
4 would have impaired TEP's financial status?

5 A. No. We have continued since that time to
6 pre-retire debt exactly on what we stated. The point
7 that I have made is not that anything has happened to
8 impair TEP's financial status, and TEP's financial
9 status will only be improved by this transaction, but
10 the fact that we currently face of maybe some higher
11 volatility than they did at the time of Mr. Larson's
12 testimony, and I have a need for more liquidity to
13 properly manage the business.

14 Let me give you an example. If
15 Springerville Unit 1 went down today, went down today,
16 and it was out for a 20-day outage, I would have to buy
17 replacement energy which would cost me over \$7 million.
18 I don't get that in rates. I have risks associated
19 which are more pronounced today than they were then
20 because of the marked increase and volatility in gas and
21 energy prices. That's all I'm saying. I'm not saying
22 that we haven't continued to improve TEP's financial
23 condition.

24 Are we investment grade? No. Should we be
25 investment grade? Based on our current numbers, no.

1 Have we been downgraded? No. Have we been upgraded?
2 No. But I'm quite proud of that because the utility
3 industry over the period of time we were discussing, the
4 last three years, I think I answered your question on
5 that, most, a good portion of my brethren have got
6 downgraded. We held the line. We didn't get affected
7 because we are continuing to try to improve TEP's
8 financial standing.

9 This transaction puts us years ahead of what
10 we can do on our current schedule and gives me more
11 liquidity to adjust to aberrations in the gas market,
12 potential plants down, and various other factors that I
13 have to face on a day-to-day basis, adding two more
14 crews in Mohave. I had two crews in Mohave. I'm going
15 to tell you that's not contained in my current costs
16 that I'm recovering. These are all additional, but it's
17 what we feel is necessary for us to do to meet that
18 current need of that customer, that current value of
19 that customer, that when that light switch is flipped,
20 the lights come on.

21 Q. All right. I understand where you're coming
22 from. I want to ask you a few more questions, though,
23 on the financial viability of the company, at least as
24 it was looked at back then.

25 A. Okay.

1 Q. The next line, line 25 and 26 on that
2 supplemental testimony, Mr. Larson states that, "Under
3 the current rate freeze." Now again, we're going back a
4 year and a half, I realize that, but when you were
5 seeking approval for that line, that line which in fact
6 you didn't take or TEP didn't take, it says, "TEP
7 anticipated to generate enough cash flow to fund the
8 50 million loan, to meet its ongoing capital expenditure
9 requirements, and to retire an average of 30 million and
10 \$50 million of debt and lease obligations each year,"
11 correct?

12 A. Yes.

13 Q. And that's due in part to TEP's strong cash
14 flows, TEP expected the credit rating agencies to
15 sustain current credit rating with TEP, even if the
16 \$50 million loan was provided, correct?

17 A. Yes.

18 Q. Has TEP's credit rating changed since that
19 time?

20 A. No, I've testified ad nauseam today, no, it
21 has not.

22 Q. Okay. And is TEP still going to be able,
23 based on projected cash flows, to meet its capital
24 expenditure requirements and retire an average of 30
25 million to \$50 million of debt if in fact the merger is

1 not approved?

2 A. I believe, yes, we will still be able to do
3 that. That would be my objective. I just say that I
4 have less flexibility in timing now because of more
5 volatility in base energy than I had at this point in
6 time. And I don't have 270 million less in debt and I
7 don't have 165 million more in equity that comes from
8 this transaction.

9 Q. Just a few more questions, Mr. Pignatelli.
10 Have you had any discussions with any other
11 entity or company about a possible sale of assets or a
12 merger since you've met with the investors?

13 A. You have to be more specific. I'm sorry,
14 that's a pretty broad question. You're talking about
15 merging with another entity or buying assets, them
16 buying from us or -- I don't know what the question is.

17 Q. Sure. I understand. Let's just keep it to
18 a potential merger like the one that we're considering
19 in this case. Has there been any discussions with any
20 other companies or entities about that sort of thing
21 since the time that you have entered into negotiations
22 with these particular investors?

23 A. What sort of -- I missed what you said.
24 What sort of thing?

25 Q. About a potential merger.

1 A. I have not discussed merging with any
2 company. I have not had any company come in and discuss
3 merging with me. I, not me personally, but as I
4 testified early on, we are under preliminary discussions
5 which could come to fruition at any point in time about
6 perhaps acquiring assets. I am not discussing any sale
7 of assets. Any acquisition of asset or any sale of
8 asset would require this Commission's approval. Any
9 merger would require this Commission's approval, whether
10 I was the acquirer or the acquiree. And I'm not under
11 any merger discussions. We are under some asset
12 acquisition discussions. We are not under any asset
13 disposition discussions.

14 Q. Mr. Pignatelli, have you or anyone in your
15 company that you know of solicited support for this
16 merger from members of the public by telling them that
17 if this merger does not actually take place, that it's
18 likely that an out-of-state company will buy the company
19 and not run it with local management?

20 A. I am not aware of that, but I have made
21 statements that I feel we are vulnerable to an outside
22 party coming in, and I've testified to that. And I
23 testified that one of the benefits of this merger is
24 that local management retention, if that's a benefit to
25 you. But if anybody, I have said, but I have not

1 threatened anybody. I've just said there's always a
2 possibility.

3 MR. POZEFSKY: Okay. Thank you. I have
4 nothing further.

5 COM. MAYES: To that point, Judge, could I
6 follow up on that question?

7 ALJ RODDA: Okay. Then we will take a
8 break.

9 COM. MAYES: It was a question I was going
10 to ask Mr. Pignatelli, but it was very clear from the
11 steady flow of folks from the community who came in here
12 that, well, A, obviously they are very supportive of you
13 and your leadership, but it seemed as though many of
14 them had been told by someone, and I don't know if it
15 was you or a member of your team, that their best chance
16 of keeping you in the fold was to support this merger.
17 So to your knowledge, has anybody on your public
18 relations team, Mr. Glaser or anyone else told them that
19 their best chance to keep this current management team
20 is to support the merger?

21 THE WITNESS: I'm sure that there have been
22 people saying that. I do not deny that we went out and
23 we requested people to support the merger. And the
24 points that we discussed with them was retention of
25 management and retention of local management, and I

1 would anticipate that that message got across. I mean,
2 the first thing I discussed with my employees the day
3 this was announced, I went out and talked to every one
4 of my employees, and I said, "You might think this is a
5 positive or a negative, but if this is done, I'm going
6 to be here five years." And that word has been out.
7 I'm not ashamed of that. It's not in the nature of a
8 threat; it was in the nature of a factual
9 representation.

10 COM. MAYES: But did you also explain to
11 these individuals that any other company that would seek
12 to buy UniSource would also have to come before the
13 Commission for our approval?

14 THE WITNESS: I don't know, I did not have
15 any discussions with anyone myself personally. Whether
16 that was made clear, I don't know. I have always made
17 it clear that any, any asset sale, anything of that
18 nature had to be approved by the Commission. And at the
19 same time I was talking to groups, I would always say
20 that the Commission retains control over the disposition
21 of assets and the company. That's why we're here. And
22 so I can't point to something.

23 COM. MAYES: Okay. And again, I don't mean
24 to suggest that any of those people who came in didn't
25 do so totally on their own volition because they truly

1 do care about the company and appreciate, you know, the
2 help and support that you have consistently given to
3 them. What I would certainly hope is that they weren't
4 given a lopsided story which would, which neglected the
5 fact that any other company that might come in also
6 would get the same scrutiny that this company is
7 getting, or these investors are getting. I certainly
8 wouldn't want them to have been given half the story.

9 THE WITNESS: I certainly agree with you,
10 Commissioner. I'm sure that it was biased. I hope it
11 wasn't lopsided.

12 COM. MUNDELL: Just let -- are you finished,
13 Commissioner?

14 COM. MAYES: Sure.

15 COM. MUNDELL: Let me follow up on that. In
16 the Daily Star on June 1st, you are quoted as saying,
17 "Indeed, Pignatelli said UniSource is having a tough
18 time surviving at its current size, and that's why the
19 company is being bought. The company won't last long as
20 it is."

21 So, I mean, that's sort of out there in the
22 media and at Rotary Clubs and Lions Clubs, and that's
23 sort of the spin that is being told to the local
24 community?

25 THE WITNESS: That's part of it, yes. It's

1 a much broader picture than that, hopefully, but that is
2 what I truly feel, Commissioner. That's not to say that
3 you don't have complete authority over the issue. It's,
4 I've been here for going on ten years now, and people
5 approach me continuously. We have had discussions over
6 that ten years, multiple discussions, other companies
7 coming in and asking --

8 COM. MUNDELL: Let me read the rest of the
9 quote attributed to you. "Within five years, I think
10 we'll be acquired by someone else and the local presence
11 will be gone."

12 Well, wouldn't we have the same ability in
13 any future application to retain current management and
14 a local presence in Tucson? That's, I guess that's the
15 concern I am having. I won't speak for Commissioner
16 Mayes or the other Commissioners, that if we don't do
17 this deal, somehow the local presence is going to be
18 gone. But we would still have the ability to put the
19 conditions on in the future, couldn't we?

20 THE WITNESS: You could put the conditions
21 on, but I must remind you --

22 COM. MUNDELL: Please remind me.

23 THE WITNESS: -- I tend towards flippancy
24 sometimes, and I'm trying to -- there was, we had a war
25 over slavery. This management team on any change of

1 control has agreements that unless they retain exactly
2 the same position with exactly the same
3 responsibilities, there are termination payments made to
4 them. If a new company came in, let's say it was
5 Pinnacle, because I'm not under any discussions, haven't
6 been for quite a while. If Pinnacle came in, I don't
7 think that I would be in the same position working for
8 Bill Post as I am now. I could immediately exercise the
9 change of control provisions in my contract, and that's
10 the same for everyone of my management. So the
11 likelihood, the high degree of likelihood is that if
12 another entity came in that had a business consistent
13 with ours, this management team would be changed out.

14 COM. MUNDELL: Well, that's a little
15 different than -- and I know you can't always believe
16 what you read in the newspaper, and sometimes they, the
17 quotes are taken out of context, but the impression
18 that's been left in the community in Tucson and Pima
19 County is just what I said a second ago, that if we
20 don't approve this merger, then somehow the next
21 applicant that comes through the doors is going to take
22 UniSource building and structures and the management
23 team out and you are going to be left with, you know, a
24 company as we heard the other day, a big oil company
25 buying UniSource or a foreign company buying UniSource.

1 So I don't think it tells the full picture.

2 THE WITNESS: Okay.

3 COM. MUNDELL: Let me follow up, though, on
4 this issue, because it's one of the major issues you all
5 have put forward in support of the merger, and that is
6 if KKR and Morgan Stanley, if we don't approve this
7 merger letting them purchase UniSource, that someone
8 else will in fact buy the company, is that correct?

9 THE WITNESS: There is a likelihood someone
10 else would come in, yes, sir.

11 COM. MUNDELL: Okay. And then according to
12 the minutes, a market test was done, and there were in
13 fact no one, no potential buyers, is that correct?

14 THE WITNESS: At that price, that's correct.

15 COM. MUNDELL: At that price. What does
16 that mean?

17 THE WITNESS: At the price of \$25.25.

18 COM. MUNDELL: Okay.

19 THE WITNESS: With the infusion of
20 \$165 million worth of equity and the paydown of 95
21 million worth of debt from the holding company back to
22 TEP. There was no potential buyer with those terms and
23 conditions.

24 COM. MAYES: One quick question; I will jump
25 in here. But Mr. Pignatelli, your board also rejected

1 an offer of, what was it, \$21. They rejected an offer
2 below \$25.25. So is it fair to say your board would not
3 accept anything below \$25.25, or --

4 THE WITNESS: I can't speak for the board on
5 that. I was not part of the deliberations.

6 COM. MAYES: You recused --

7 THE WITNESS: I wasn't even part of the
8 deliberations. I was not on the Strategic Advisory
9 Committee.

10 COM. MAYES: Okay.

11 THE WITNESS: Would the board take something
12 less than 25.25? It was a close decision. But also
13 part of the conditions that the board required was
14 management retention, was local office retention, was
15 quite a few of those six initial stipulations in the
16 document. So it was more than just price. And I'm sure
17 we're going to talk a little bit later about the
18 obligation to the community, et cetera, because our
19 board deliberated long and hard over that issue before
20 the Strategic Asset Committee even met about what is the
21 roles or what's the responsibility of the board. The
22 Strategic Advisory Committee negotiated the transaction.
23 What they would have taken, looking at terms and
24 conditions, I don't know.

25 COM. MAYES: Well, I thought that at some

1 point, maybe not during this, maybe it was from another
2 suitor, I thought there was another suitor that the
3 board rejected an offer from prior to this time period.

4 THE WITNESS: Well, J.P. Morgan Chase and
5 Madison Dearborn --

6 COM. MAYES: Madison Dearborn, right.

7 THE WITNESS: -- came in and said that they
8 would pay, it was in the 19, \$20 range, and I didn't
9 even take that to the board. I said no, I would not
10 take that to the board. I probably discussed it with
11 the board, but I didn't take it as, I didn't accept an
12 offer. See, again, the problem, we accept an offer,
13 then we are, when it goes to that next level. We get
14 into issues with public knowledge, et cetera, and we
15 have to be very careful on disclosure requirements. So
16 that never really got to a formal -- now, this group
17 came in over time.

18 They initially -- and I'm sure we'll discuss
19 my comments around that, especially one that you
20 addressed vis-a-vis this group is my comment that this
21 group is not properly valuing the regulated entity,
22 because the initial, they came in with an initial
23 approach which was a certain amount per share for
24 TEP/UES, and either a participating note or spin off the
25 others. And the board determined that they, they wanted

1 the whole package, even though I said that included in
2 the total price might not be what we value Global Solar
3 at, because my board had a certain opinion as to the
4 intrinsic value of Global Solar. It's not because there
5 are not any, the buying group isn't interested in Global
6 Solar. It's just in their valuation process, I didn't
7 think they were giving the same intrinsic value as the
8 board anticipated. So there were a whole -- but I was
9 not in the negotiations.

10 COM. MAYES: Okay.

11 ALJ RODDA: I just think it's going to go
12 on, so I think we need to take a ten-minute break here
13 and pick up then.

14 (A recess ensued.)

15 ALJ RODDA: Let's go back on the record.

16 I believe Mr. Pozefsky was finished with his
17 questions, and Commissioner Mundell, perhaps you were in
18 the middle of something, and I made you take a break.

19 COM. MUNDELL: Yes, I just have, on the
20 issue we were talking about, I will ask a couple
21 questions, then I guess we will go to Mr. Kempley.

22 MR. KEMPLEY: You know, Your Honor,
23 Commissioners, if it's most orderly, I can say right now
24 that I don't have any questions. You can move to the
25 Commissioners' questioning directly.

1 ALJ RODDA: Okay.

2 COM. MUNDELL: Let me ask you,
3 Mr. Pignatelli, you talked about one of the reasons that
4 we ought to approve this sale, merger, whatever
5 terminology you want to use, is that if we don't allow
6 this merger, some other purchaser will come along in the
7 near future, is that correct?

8 THE WITNESS: That's correct, sir. I think
9 that although this company is improving and continuously
10 improving financially with the help and assistance of
11 the Commission that I think the, and I think one of the
12 panel members indicated yesterday that the 25.25, if
13 that was rejected, the stock would fall back into the
14 place it would be potentially an attractive takeover,
15 the stock would fall back into the mid- to high teens,
16 trading on its, in its own substance.

17 COM. MUNDELL: New Harbor, Incorporated,
18 what is their relationship in this transaction?

19 THE WITNESS: New Harbor has been an advisor
20 to the company for many years. They assisted us in the
21 Citizens acquisition. They have looked at other asset
22 acquisitions for us. They gave advice on dividend
23 policy. They helped on the, arranged the financing for
24 Citizens. They've been around the company for many
25 years.

1 Now, in this transaction, they were the
2 advisor to the company, and then the Strategic Advisory
3 Committee felt that they wanted another advisor so that
4 there was a good degree of separation and had a complete
5 independent view, even from the company's advisor on
6 this matter. And in fact, the Strategic Advisory
7 Committee listened to the company's advisors, the
8 long-term company's advisors, which was Reid & Priest on
9 the attorney side and then New Harbor on the financial
10 side, but the Strategic Advisory Committee actually
11 hired their own financial advisor, Morgan Stanley, and
12 their own outside counsel. That was a local firm, and I
13 can give you the name, but I can't remember what the
14 name was. It's Fennemore Craig.

15 COM. MUNDELL: Could you turn to the
16 document 04332.

17 THE WITNESS: May I ask that it be brought
18 to me?

19 COM. MUNDELL: Sure. I just assumed
20 Mr. Heyman was going to do that for you. 04332.

21 MR. HEYMAN: Almost there.

22 COM. MUNDELL: What happened to your trusty
23 computer?

24 MR. HEYMAN: I could bring the computer up
25 to him, but that might be even more awkward.

1 THE WITNESS: He might have a suggested
2 answer in his computer.

3 MR. HEYMAN: I've got it.

4 THE WITNESS: Okay.

5 COM. MUNDELL: Well, let me ask some
6 foundation. As I understand it, this was a document
7 that was presented to the committee, the Transaction
8 Committee, and could you explain this to me? It's
9 entitled Little Interest in Transactions, and then it
10 goes western utilities uninterested, and I won't name
11 the companies, but it names three companies, then it
12 goes sorting out their own problems, it names five
13 companies, then says too small or too far away, names
14 six companies, and then hard to figure out, it names
15 two.

16 I guess I'm a little confused by this with
17 the, your statements that if, you know, we don't approve
18 this transaction, someone else will be interested in
19 this company and buy it.

20 THE WITNESS: New Harbor as I said has been
21 a long-term advisor to the company, and various of these
22 parties listed had approached New Harbor over time to
23 solicit information about the company. Others New
24 Harbor was telling the board would not be interested
25 because they either had their own problems or they were

1 too small or they were too far away. But this was all
2 in the context of the terms of the transaction, the
3 estimated terms of this transaction. And what New
4 Harbor was indicating was they did not feel, and I don't
5 know at what time this was versus when the actual, shall
6 we call it market check, went out, because Morgan
7 Stanley independently went out and contacted some firms.
8 So I don't know whether this was contemporaneous they
9 were telling the board this, or whether it was before or
10 after. But New Harbor was giving its opinion as to the
11 likelihood of these companies being interested under the
12 terms and conditions which were then under discussion.

13 COM. MUNDELL: Okay. Well, I think that,
14 and it may not correlate, but I think they correspond to
15 the minutes of the Transaction Committee of November 11,
16 2003, because on 0646 that I read the other day to you,
17 it says he reviewed, meaning Mr. Moore, reviewed the
18 discussions the firm had with other parties and noted
19 that no interest in pursuing a transaction has been
20 demonstrated. And this is the presentation I assume
21 that was made, and it lists 16 companies that are not
22 interested in purchasing UniSource.

23 THE WITNESS: These were not, these 16
24 companies were not all contacted. Morgan Stanley
25 contacted I think five or -- I don't know how many

1 Morgan Stanley contacted. The only reason I was --

2 COM. MUNDELL: How would you know that if
3 this went to the Transaction Committee and not to you
4 because you had recused yourself from it?

5 THE WITNESS: That's what I am saying.
6 That's why I'm hedging my bet, I hedge my answer, and I
7 said I didn't know the time frame and what point in time
8 the, this presentation was made vis-a-vis where the
9 Strategic Advisory Committee was in negotiating the
10 terms and conditions. If this was presented in -- and
11 actually, I think I was there when this was presented,
12 was contemporaneous with Morgan Stanley indication, then
13 this was an opinion based on the terms and conditions at
14 that point in time which were the 25.25, local
15 management retained, local operations maintained, local
16 offices maintained, local contributions maintained,
17 infusion of 270 million of cash into the business. So
18 the only reason I hedge is I wasn't quite sure what the
19 condition of the negotiation was when this was
20 presented.

21 COM. MUNDELL: Well, I appreciate that
22 answer, but, and I'm not saying you're right or wrong.
23 It's just earlier in the minutes, it talks about the
24 price hadn't been set yet. I mean, as I understand this
25 on 00645, Mr. Beatty is presenting an overview of

1 issues, and it says, "Finally, with respect to price, he
2 advised the board that while he believes the
3 shareholders can receive a price above the \$24.50-25
4 proposed by the investor, it is unlikely the investor
5 group would offer a significantly higher price." So I'm
6 not sure exactly where it is in the negotiations also,
7 but in any event, if it was based on all the terms and
8 conditions we are here discussing today and there were
9 no takers, so be it. I just think it needs to be put on
10 the record that, you know, those minutes speak for
11 themselves.

12 I don't have any more questions on this
13 issue. I don't know if Commissioner Mayes wants to
14 start her line of questions, or I can continue. It
15 doesn't -- she hasn't had a chance to ask questions, so
16 I don't know --

17 ALJ RODDA: Maybe before we start with
18 Commissioners, we could ask Mr. Goldstone, are you still
19 there?

20 MR. GOLDSTONE: Yes, I am, Your Honor.

21 ALJ RODDA: Did you have some questions for
22 Mr. Pignatelli about --

23 MR. GOLDSTONE: Yes, I do, and I appreciate
24 the opportunity to speak, Your Honor, and Commissioners.
25

1 CROSS-EXAMINATION

2

3 Q. (BY MR. GOLDSTONE) Mr. Pignatelli, my name
4 is Marc Goldstone. I'm representing the Punto de Vista
5 Property Owners Association. I heard your testimony
6 maybe an hour or two ago, and I do have some questions.

7 First, you had mentioned that there were two
8 outages and that they were not your fault and that they
9 were associated with the WAPA, which I believe is the
10 Western Area Power Authority. And in particular, as my
11 testimony stated, the power for the Punto de Vista is
12 one square mile and 500 or so customers comes from the
13 Davis Dam Hydroplant and through the Warm Springs
14 Substation and to our homes nearby. This is a little
15 island that you're servicing that is part of the
16 UniSource territory, and you also mentioned that there
17 were only two outages. Well, you have a certain time
18 period, and I'd like to ask you what that time period is
19 where you're required to list or make note of an outage.

20 A. Is your question what is the minimum time,
21 if it's a momentary, what's the duration before it's an
22 outage?

23 Q. That's correct.

24 A. You know, frankly, sir, I don't, I don't
25 know. I can only go off of what was provided here. I

1 will say in a momentary average interrupt, frequency
2 interruption, the number that has been provided to me is
3 that, and I'll just speak of UES -- no, I'll speak of
4 both. At TEP, the momentary average interruption
5 frequency index is 4.1 for 2003, and 5.72 for 2003 for
6 Punto de Vista. It's actually your area. The U.S.
7 average is 4.5. Now, through May of 2004, TEP's
8 momentary average interruption frequency index is .8 for
9 TEP, and zero for Punto de Vista. That is what I have
10 been provided, but also I would counsel or caveat that I
11 would expect Punto de Vista to have a little bit higher
12 momentary average frequency interruption frequency index
13 because it's overhead, almost all of it is overhead
14 where TEP has a significant underground, and we haven't
15 had storm season yet up there. So I've always said I'm
16 not taking any credit for this at this point in time
17 because we haven't had storm season.

18 Q. Mr. Pignatelli, I appreciate your answer and
19 numbers thrown out, but I did note that they didn't have
20 units or at least I did not hear the units. 4.1 or 5.72
21 really is meaningless to me and invariably to the people
22 whose lights go out and VCRS and computers flicker and
23 start showing 8s, 88:88 that we're all so familiar out
24 here. It's so frustrating to have to reprogram our
25 equipment.

1 A. I understand, and we are doing everything we
2 can. The only thing, I would also submit that my
3 transmission engineers have indicated that, and this is
4 responsive to your comment that the line comes from some
5 hydrofacilities, and I'm not aware of how that's fed.
6 They've only said that whether this subdivision was fed
7 by UniSource Electric or Mohave Electric, the
8 electricity still had to come over the same lines, the
9 Western Area Power Authority lines, and that the major
10 interruptions were resulting on that line so that in
11 actuality, any change of boundary would not necessarily
12 change, improve your reliability.

13 Q. Well, Mr. Pignatelli, I could take note of
14 that specifically, because we are up on top of the hill
15 and can see the lights down below us during blackouts
16 that occur during the evening hours, and the lights seem
17 to be on in the Mohave Electric Cooperative area during
18 these long evening outages, at least they have been in
19 the past.

20 But the electricity provided by Davis Dam is
21 a direct feed from the generators on the dam, yet the
22 WAPA lines are fed by that also. Now, what that means
23 is WAPA has other sources of energy that are feeding
24 into Bullhead City and the Mohave Electric Cooperative,
25 your competitor, that surrounds us here in Puento

1 de Vista, and they have means of pulling power off that
2 grid even if Davis Dam is down. We have spoken as a
3 homeowners association with some of your representatives
4 last December, and that's how I got all this information
5 on how and where the power comes from.

6 A little bit of history that's very
7 important --

8 ALJ RODDA: Mr., I'm sorry, Mr. Goldstone --

9 Q. (BY MR. GOLDSTONE) -- could you explain,
10 Mr. Pignatelli, how UniSource and before them Citizens
11 came to provide power to our little teeny one square
12 mile community?

13 A. I missed it, the point of this is what's the
14 history of how UES and TEP came to --

15 Q. How you came to be providing electric power
16 to our little community which is surrounded by area
17 provided by MEC. I do know the answer and would be
18 happy to elaborate, but I thought I would give you a
19 moment to comment on that.

20 A. I have no idea of the history. I know how
21 UniSource came to acquire it. We acquired Citizens.
22 How Citizens came to acquire it, I don't know.

23 Q. Okay. I would like to elaborate on that.

24 The Punto de Vista area is part of the Thumb
25 Butte Mining District. Prior to World War II, it was an

1 active mining area, as was nearby Kaplan Landing, one of
2 the largest gold mines in the country, and certainly in
3 Mohave County. That power was provided invariably over
4 your line coming down from Kingman through Union Pass
5 that I had previously complained is not a reliable
6 backup source of power when the Davis Dam is not able to
7 provide the power to our community.

8 So basically, 80 hundred years ago, Kingman
9 was the local power generation facility, and it provided
10 power to Punto de Vista because this is all that was
11 here. There was no Bullhead City and no Mohave Electric
12 Cooperative back in those days. Mohave Electric
13 Cooperative grew and started to surround the Punto
14 de Vista community. It provides local service; you
15 don't have a facility here local. You have to bring
16 your repair people in from Kingman unless as I have seen
17 in the last few days they're stationed in our community,
18 which I know won't last, sitting in their trucks and
19 ATVs patrolling the line.

20 MR. HEYMAN: At this point, with that
21 comment, I would ask that the examiner be instructed to
22 ask a question.

23 ALJ RODDA: Mr. Goldstone, do you have a
24 question after all this?

25 MR. GOLDSTONE: Yes, there probably is.

1 Thank you for getting me back on track. Give me just a
2 moment.

3 Q. (BY MR. GOLDSTONE) Okay, Mr. Pignatelli,
4 you had mentioned that there were millions of dollars
5 spent upgrading the electric system. I would like to
6 know what expenditures have directly benefited our local
7 community.

8 A. I don't know the answer to that.

9 Q. Okay. Because I haven't seen an increase in
10 infrastructure. I still see the same wires.

11 ALJ RODDA: Mr. Goldstone, just ask
12 questions, okay?

13 MR. GOLDSTONE: Okay. Got it.

14 Q. (BY MR. GOLDSTONE) I had read, and this is
15 part of a question, that there is a \$25 million good
16 faith amount that UniSource would pay the suitors. Can
17 you explain who ultimately would pay that \$25 million
18 good faith payment, if the Corporation Commission deemed
19 that this leveraged buyout should not proceed?

20 A. That would not, if this Commission
21 determined that this acquisition of our stock should not
22 be approved, the number is not 25 million, it is capped
23 at 7 million, and that's paid by UniSource Energy
24 stockholders.

25 Q. So this would actually result in a market

1 reduction in value of the company if that payment were
2 made?

3 A. I don't believe that \$7 million paid by our
4 shareholder would influence our market price.

5 Q. Okay. Nice to run such a big company where
6 that would be the case.

7 COM. MUNDELL: Just to clarify, what was the
8 dollar amount you just said?

9 THE WITNESS: I believe that 7 is the
10 maximum. I had previously testified to 8, but I believe
11 it is 7.

12 MR. GOLDSTONE: I had actually read 25 in
13 one of the Corporation Commission documents.

14 THE WITNESS: The 25 is commonly referred to
15 as a topping fee which is only paid to the investors in
16 the case that there is a new acquirer within the next 12
17 months, and that is paid essentially by the new acquirer
18 because they have to make the shareholder whole. They
19 have to put a better deal before the shareholder, and
20 the shareholder is not going to approve something that
21 they net less out of.

22 Q. (BY MR. GOLDSTONE) It seems to me that
23 UniSource Energy isn't broke and doesn't need fixing or
24 sale, but that's my personal opinion.

25 ALJ RODDA: Mr. Goldstone, please.

1 MR. GOLDSTONE: Okay.

2 COM. MAYES: Quickly, on that point,
3 Mr. Goldstone, could I jump in real quick here?

4 MR. GOLDSTONE: Yes.

5 COM. MAYES: I thought I read in the minutes
6 here somewhere that KKR originally proposed a
7 \$10 million hit should this, should the ACC not approve,
8 is that correct?

9 THE WITNESS: I believe that the investor
10 group was arguing for a higher amount, and the board
11 started at zero. They started at something higher, and
12 my understanding of the negotiations is it was settled
13 out at actual costs to be capped at 7 million.

14 COM. MAYES: Okay. So the actual costs have
15 to be proven out. What does the \$7 million represent?
16 Is that legal fees, is that consulting fees, what is
17 that?

18 THE WITNESS: You've named it, legal fees,
19 consulting fees, their travel, their time they've spent
20 on this. There's been a tremendous amount of due
21 diligence, I can tell you, and I am sure that the bills
22 that they have far exceed \$7 million, not that they've
23 been invested. But they would have to prove it up.

24 COM. MAYES: And it covers a time period of
25 what to what? I mean, what is the first day you set

1 eyes on these guys?

2 THE WITNESS: You know, I don't, it would
3 have a contained time frame, but I'm sorry, I don't know
4 that.

5 ALJ RODDA: Mr. Goldstone, you can continue.

6 MR. GOLDSTONE: Thank you very much.

7 Q. (BY MR. GOLDSTONE) Mr. Pignatelli, the next
8 issue is that of rates in the Punto de Vista area. I
9 understand the rates are set by the Corporation
10 Commission. Your rates are currently about 11 percent
11 higher than the surrounding communities serviced by
12 Mohave Electric Cooperative. Can you explain why this
13 is the case?

14 A. Yes, I can give you at least part of the
15 reason. I don't know the entire reason because I
16 haven't made a detailed study of Mohave Electric Coop.

17 But in general, coops have some priority to
18 governmental power, power from navigable waters,
19 et cetera, that the rest of the taxpayer is subsidizing.
20 And Mohave Electric I would imagine has some of that
21 access to what we call preference power. To be
22 contrasted with UniSource Electric, all of UniSource
23 Electric's power is purchased under a contract with
24 Pinnacle West that that contract right now since we
25 acquired the company and to date is better than we could

1 obtain otherwise in the market. And we've been filing
2 reports with the Commission on various aspects of our
3 attempts to improve on that contract which we have not
4 been able to do because actually market, the market cost
5 of power is higher than that contract. In fact, we've
6 given some customers the ability to go and try to
7 acquire power from the market on their own, and they
8 have come back and said, "Well, we can't get prices
9 better than that." So Mohave Electric, if its rates are
10 lower, it's a function -- and it might be only for a
11 short period of time, because I don't know how they buy
12 their power, that there is some excess preference power
13 available to them.

14 Now, the mere fact that you would go with
15 Mohave Electric, I don't know if there's additional
16 excess power available, preference power for you. I can
17 only say that right now, I would attribute the majority
18 of the difference to their acquiring preference power
19 where as a publicly-owned entity, we don't have that
20 ability. We don't have the right to do that.

21 The other thing I would submit that Mohave
22 Electric probably has is tax exempt debt. Now, we have
23 some tax exempt debt at TEP, and there's also some tax
24 exempt debt at UniSource Electric and Gas, but not all
25 of our debt is tax exempt. So we have a little higher

1 interest cost.

2 I also -- Mohave Electric, I don't know if
3 they are profitable. I don't know the other subsidies
4 that might flow from other things, but we do have
5 earnings and we do pay taxes, so that also contributes
6 to a differential in being a privately-owned tax-paying
7 entity versus a municipal or government agency that
8 doesn't pay taxes.

9 Q. Well, thank you for your comments on that.
10 It's interesting to note as previously stated that all
11 of our power in Punto de Vista comes from the Davis
12 Power Plant which would be that very same
13 hydropreference power that Mohave Electric gets some
14 portion of its power from. So you're providing
15 100 percent preference power to our little teeny
16 community of 500 homeowners --

17 A. Sir, can I --

18 Q. -- and for that preference power, it should
19 be cheaper, yet we are paying the rate as if this was
20 coming from Pinnacle West at a much higher rate. Very
21 unusual arrangement.

22 A. Sir, let me --

23 Q. And that because I think UniSource is
24 looking at its service territory as a whole, not the
25 little teeny dot on the map in northern Mohave County

1 called Punto de Vista.

2 A. Let me clarify your misconception, sir.
3 Electrons flow where electrons flow. We don't buy
4 preference power. I don't have the right to buy
5 preference power. Now, if the electrons flow from
6 Parker Davis that is being supplied you or whatever the
7 dam you said was supplying you, I'm paying for power at
8 a different point, and the power electrons are flowing
9 wherever they flow.

10 Q. Okay. Being an electrical engineer, I'm
11 certainly familiar with where electrons flow and how
12 they do that. Since our connection is directly to Davis
13 Dam, it seems like an accounting issue, not an argument
14 about where electrons flow and the fact that they like
15 going downhill from supply to demand.

16 A. But sir, I don't buy the power at that dam.

17 Q. I'm sorry, I couldn't hear that.

18 A. I do not buy the power at that dam. I have
19 to --

20 Q. Our power is being delivered directly
21 through the Warm Springs Substation from Davis Dam. As
22 stated, when WAPA has an outage which happens to be at
23 that Dam, our lights go off.

24 ALJ RODDA: Okay. Mr. Goldstone, there's --
25 you both are talking past each other about where he

1 purchases the power versus where the power actually
2 comes from. Those are two different issues, but you can
3 argue that later if you think it's relevant. But can
4 you move on and proceed if you have additional
5 questions.

6 Q. (BY MR. GOLDSTONE) Yes, one last item,
7 Mr. Pignatelli. I am very interested in renewable
8 energy as are many of the other homeowners in Punto
9 de Vista. Currently there is a buydown program for
10 folks that put in solar. There is no buydown program or
11 incentive for people to put in wind. I would like to
12 know whether UniSource Energy will work with the
13 Corporation Commission to see that not only solar but
14 wind and other forms of renewables be made available and
15 incentivized, if that's a word, for your consumers,
16 certainly in Punto de Vista and preferably statewide?

17 A. Yes, sir, we are very interested in all
18 forms of renewables. In fact, my shareholder has spent
19 over \$65 million in developing solar products, none of
20 which is going to any consumers, but is absorbed by my
21 shareholder.

22 In addition, if you were listening to my
23 testimony earlier, we are looking at the acquisition of
24 various resources currently, and we are under
25 discussions with some parties vis-a-vis wind.

1 Q. Okay. You don't actually have to own the
2 company that makes the equipment that would allow people
3 to produce energy with wind --

4 ALJ RODDA: Mr. Goldstone --

5 Q. (BY MR. GOLDSTONE) -- but you need to have
6 a regulatory means between you and the Corporation
7 Commission to incentivize people to be able to buy that
8 from whomever the source, install it and provide utility
9 intertype power to your network, and that is what I
10 would like to see happen.

11 ALJ RODDA: Okay. Is there a question?

12 Q. (BY MR. GOLDSTONE) Is that what you mean,
13 Mr. Pignatelli? Do you expect to encourage individual
14 investors to be able to put in wind and other means of
15 renewables, even if they don't purchase that equipment
16 from you?

17 A. We have currently programs in place to
18 assist in solar on the individual distributed basis. At
19 the current time, I am not aware of any subsidies we
20 give to anyone to put wind in on an individual basis.
21 One of the unfortunate things is any time I subsidize
22 one particular customer, I have to recover that from
23 another customer, and I face that dilemma as long, as
24 well as RUCO and the Commission faces those dilemmas.

25 Q. Okay. Thank you for that response, and I'm

1 hoping the Corporation Commissioners will give due
2 credence to deployment of wind energy and the
3 incentivization to make it as popular as solar for
4 individual homeowner investors, if you will.

5 COM. MUNDELL: This is Commissioner Mundell.
6 Let me jump in for a second.

7 As I speak and as we sit here, there is a
8 workshop going on in Phoenix on expanding the renewable
9 portfolio. I mean, that's what's happening.
10 Commissioner Mayes and I can't be two places at once,
11 but there is a docket going on and discussions going on
12 today. And so you are certainly welcome to participate
13 in that docket, and I would encourage you to do that.

14 MR. GOLDSTONE: Gee, I would love to do
15 that. Phoenix is a bit far. I don't suppose they have
16 a dial-in program.

17 ALJ RODDA: Do you have anything further for
18 this witness?

19 MR. GOLDSTONE: No, I don't, and I thank the
20 Court and Commissioners for hearing my testimony and
21 Mr. Pignatelli for trying to answer it. Thank you very
22 much.

23 ALJ RODDA: Thank you, Mr. Goldstone. Are
24 you going to stay on the phone?

25 MR. GOLDSTONE: If you need me, yes.

1 Otherwise I'll probably log out.

2 ALJ RODDA: I don't need you.

3 MR. GOLDSTONE: Okay. Thank you very much
4 again.

5 ALJ RODDA: Thank you.

6 Commissioners Mayes, did you have some
7 questions?

8 COM. MAYES: Yes, sure.

9 Mr. Pignatelli, going back to the issue, you
10 had started to discuss the Global Solar situation, and
11 the discussion throughout the minutes, I think at least
12 on three different occasions in which various
13 individuals broached the idea of spinning off MEH, well,
14 Global Solar is part of MEH. That's one of the
15 companies, those entities, is that correct?

16 THE WITNESS: That's correct.

17 COM. MAYES: Just to go back, you don't need
18 to turn to the page, I'm sure you remember it and I
19 mentioned it before, but on page, in the November 4th,
20 2003 minutes, Mr. Handy asked about the possibility if
21 Global Solar could be spun off or sold off before the
22 closure. You argued against it. Why did he argue, why
23 was that being broached at that time and what were your
24 arguments against it?

25 THE WITNESS: Mr. Handy was concerned that,

1 or had an opinion that perhaps we could get more money
2 for Global Solar by spinning it off and selling it to
3 the marketplace, thereby enhancing the value to our
4 shareholder. And I think I need to put something in
5 perspective. We've talked about premium to the
6 shareholder, 30 percent premium. That's a reflection of
7 price, the movement one day to the next.

8 After Commissioner Spitzer had asked a
9 question relative to the return of the investment of our
10 shareholders, I went back and looked, and we went public
11 in 1946. And if I adjust the initial public offering
12 for splits and other things, the price today, not
13 adjusted for inflation, that we went public at was
14 12.50. And the shareholder, if they would have bought a
15 share of stock in 1946 and is selling it for 25.25 today
16 has earned less than, has earned around one percent on
17 their investment. So I said, "well, let's go a little
18 closer."

19 A shareholder that owned the stock
20 immediately before the difficulty the company had would
21 have bought the stock for around \$62 with a reverse five
22 for one. That's about \$310, so that shareholder is
23 selling a piece of paper that they sold, paid \$310 for,
24 they are selling it for 25.25. So I think we can all
25 assume they lost money. So I went back a little bit

1 less, and I said what about ten years ago, because that
2 is when I came, and what if I would have invested \$100 a
3 year every year that I've been at the company, what
4 would my return be? Eight percent, that's what a
5 shareholder who had steadily invested over eight years,
6 or over ten years, eight percent.

7 I looked back, and at the height of the
8 California condition, the stock sold at 25.99, so that
9 shareholder lost money.

10 So I don't think we can immediately seize
11 upon 30 percent premium and feel that the existing
12 shareholder is making some great benefit because the
13 returns consistently over periods have been less than
14 the authorized return, and that's to be expected because
15 we were spending money in Global Solar. We were taking
16 profit, return on shareholder investment which is
17 authorized in the 10 to 11 percent by this Commission,
18 and this Commission doesn't set a return on the market
19 price of the stock. We don't price -- when that light
20 goes on, it doesn't say, "You're going to need a
21 10 percent return on whatever the market value of the
22 stock is." It's whatever is the investment in the
23 company.

24 So the board was very concerned that it
25 maximize the value of every discrete asset in this

1 purchase so that they could produce a better return for
2 the shareholder, you might say, on their exit. I
3 disagreed on two fundamental, for two fundamental
4 reasons. One is I didn't think the market would accept
5 Global Solar at its size. And secondly, Global Solar is
6 integral to my strategy in meeting my public service
7 obligation because I am very concerned about the
8 negative impact that an energy-consuming entity like us,
9 we take a base energy, coal or natural gas, and we burn
10 it, produce electricity. We produce things that may
11 harm the environment, and I think it's my obligation, my
12 personal obligation, my moral obligation, and my
13 company's obligation to mitigate that as much as
14 possible. And I want to keep that going. It's the
15 right thing to do, and that's why I disagreed with
16 Mr. Handy, and you can see that in there.

17 COM. MAYES: Yes, it's very evident. Like I
18 said when I first brought this up, I think it's
19 commendable that you fought that effort. And I am not
20 worried about you, Mr. Pignatelli. I am worried about
21 the folks who are wanting to buy your company. And I
22 guess what I'm seeing in these minutes is something that
23 scares me, which is an indication apparently by the
24 buyers and maybe some other members of your current
25 board that they wanted to sell off pieces of this

1 company, albeit unregulated pieces of the company,
2 before the sale even occurred.

3 And let me just, you know, I'll give you a
4 chance to answer, but let me point out some of these
5 instances. Mr. Carter stated that the first offer from
6 J.P. Morgan Partners and KKR included spinning off
7 Millennium to the shareholders. He stated that the
8 board turned down that offer because they did not
9 consider Millennium an appropriate company for spinoff
10 at this point.

11 Then on, again on page 15 which I referenced
12 before, it says, "Mr. Pignatelli stated that he feels
13 these two entities are important to the company and
14 feels the buyers are being short sighted in their lack
15 of interest in these investments."

16 So my question is am I correct in assuming
17 from these statements that the buyers, KKR, wanted to
18 sell off Global Solar and Millennium Energy?

19 THE WITNESS: No, you're incorrect in that.
20 What was happening is the buyers were coming in with a
21 valuation for the total company, and the buyers were
22 really looking at buying the utility, and the portfolio
23 of Millennium, they weren't digging into value at that
24 point in time. And Mr. Handy and others felt that the
25 value ultimately that the buyers would provide in the

1 transaction if the buyers were to take Millennium would
2 be less than what Mr. Handy valued Millennium at or felt
3 that the marketplace might value Millennium at. And my
4 contention and others, and if you go through the
5 minutes, you can see discussions on making sure that all
6 constituencies were provided for, and it talked about
7 community. It wasn't just a strict legal standard.

8 We struggled. The board struggled.
9 Initially, there was a very strict, just the legal
10 basis, "Who do you owe your obligation to? You owe your
11 obligation to the investor." Then if you read the rest
12 of the minutes, the rest of the board said, "No, we have
13 a broader," and I was counseling, we have a broader
14 responsibility. And in that quote, or in those
15 passages, what my concern was was coming across that
16 these entities have more -- if it's -- benefit. And
17 benefit to me isn't an immediate cash benefit. It's
18 benefit. There's nothing that defines benefit to equal
19 cash. And I said these have intrinsic benefits to us
20 that are current, and we need to continue to utilize
21 these. And actually, now the sponsors have come around
22 to my position. They understand why Global Solar is
23 important. Now, some of the other Millenniums I have
24 been disposing of because they were too much of a drag
25 and were too much maybe outside what I felt was

1 beneficial.

2 But these buyers are committed, honestly, to
3 my strategy. Commissioner, I would not bring this to
4 you if I didn't feel confident in it.

5 COM. MAYES: And again, it's not about you,
6 Mr. Pignatelli. I mean, you know, but what I'm afraid
7 here is you're seeing sort of a microcosm of future
8 struggles for the soul of this company, I mean, where
9 Jim Pignatelli is having to fight with Mr. Rentschler or
10 people above Mr. Rentschler who want Jim Pignatelli to
11 do things that Jim Pignatelli doesn't think is good for
12 the State of Arizona. You know, I believe that you
13 have, you know, other interests at heart besides profit
14 margin. I do, because I think you've shown that, but
15 that's not what I'm worried about.

16 THE WITNESS: If I might respond with a
17 little history on this. Honestly, we, I've struggled
18 with this, and it's maybe my concern that Commissioner
19 Mundell and I were talking about some other party coming
20 in. I go back with Henry Kravis and George Roberts to
21 the time I was 18 years old. I know the values that
22 they possess, and I've talked to these men many times.
23 I go back to the people at J.P. Morgan for some 15
24 years. They are investing in renewables. I'm surprised
25 they didn't tell -- maybe they just -- I don't think

1 it's confidential. They're investing in fly wheel
2 technology and other things. They know as energy
3 investors that it's a broad spectrum that they need to
4 understand.

5 Commissioner, I would not have brought this
6 unless I was confident in those people that they will
7 allow us to do the right thing, and the right thing is
8 continued R&D in solar and wind and distributed
9 generation. And I'm confident. I wish you felt as
10 confident as I do.

11 COM. MAYES: Did -- how long did it take you
12 to back them off this idea?

13 THE WITNESS: Really, it was the board, and
14 the board saying, discussing, I guess, the amounts. I
15 told the investors, I said -- you know who might have
16 backed them off, to be honest with you, in understanding
17 is that Global Solar, we can say, you know, it's costing
18 this and this and this, but it's allowing Tucson
19 Electric to have credits against its renewable portfolio
20 standard, and allows us not to have to build as much
21 central generation. And actually, John Kyle, he said he
22 didn't want me covering the desert with solar
23 collectors. And I said, "John, we've got to do
24 something." But actually, Global Solar permits us to
25 have a new technology that is more suitable ultimately

1 to commercial products and to distributed products,
2 distributed households, than put, continuing to put in
3 large central stations, even though large central
4 station is the most economic at this point in time.

5 COM. MAYES: And you get extra credit
6 multipliers for that, is that right?

7 THE WITNESS: I'm not sure how it works. I
8 think we get some discount, actually, but --

9 COM. MAYES: Yes, I think you do.

10 On page, the minutes from September 30th,
11 2003, again, it came up, and I think you, it says,
12 "Finally, he," meaning you, "discussed his view of how
13 MEH would be managed and operated if it were to be
14 distributed to shareholders indicating he believed the
15 entity would have positive cash flow." So you did
16 engage at least in the hypothetical discussion of
17 spinning off MEH?

18 THE WITNESS: I will say that the board
19 asked me continuously about how I valued those entities.
20 We had one other issue, and that is a son of one of the
21 board members works for Global Solar, and she actually
22 recused herself.

23 COM. MAYES: Right.

24 THE WITNESS: So if you wonder why some of
25 the people weren't on the special advisory committee, we

1 were very strict in the -- I shouldn't say we. The
2 board was very strict on who went on that so that there
3 was no conflict of interest or nobody could allege a
4 conflict.

5 COM. MAYES: Right. But you did engage in
6 that discussion with them, because apparently several
7 people were interested in it on the board.

8 THE WITNESS: Several of the board members?

9 COM. MAYES: Yes.

10 THE WITNESS: Yes, the board members agreed
11 with me. The board members agreed. And I think you get
12 into the progression of the minutes, we get away from
13 this strict legalistic, it's only the shareholder, and
14 you start to see the board discussing more, "No, we've
15 got to look at all our constituencies." Mr. Glaser was
16 in there saying, "The regulator is a constituency. We
17 have to consider the regulator, we have to consider the
18 community."

19 The board -- we live in this community. The
20 board members and myself live in this community, and we
21 know what's important to this community, and we took our
22 responsibilities and they took their responsibilities,
23 it, it weighed heavy on them. It's not easy to come in
24 and recommend the sale of the hometown entity.

25 COM. MAYES: Yes, and I get that flavor from

1 the minutes. But can you tell me how it is that you
2 were, for instance, in this particular special meeting
3 of the board of directors on September 30th, who is
4 broaching the subject of spinning off and selling off
5 these pieces? Is it -- I mean, because you're
6 obviously responding to somebody, but it's not the board
7 of directors because they are with you on this. Is it
8 Morgan Stanley, is it KKR, who is in the meeting who is
9 bringing this up?

10 THE WITNESS: I think what's happening there
11 in those meetings is that different board members are
12 saying, "How do we maximize the value." And, but at
13 the same time they are saying, "But we have these other
14 constituents." There is a ying and a yang going here.
15 And they generally brought me in to give them advice on
16 where I felt valuations were, where I felt business
17 prospects were, and what I felt, why I felt so strongly
18 that it was essential that Global Solar be retained.
19 And they were bringing it -- and that's what you see.
20 This is a process.

21 COM. MAYES: But someone from Morgan Stanley
22 was bringing this up. Wasn't it Mr. Moore?

23 THE WITNESS: Morgan Stanley under the
24 direction of Mr. Moore was the advisor, independent
25 advisor to the Strategic Transaction Committee.

1 COM. MAYES: Okay.

2 THE WITNESS: And Mr. Moore would be the one
3 that was making the presentations. And he for his
4 fairness opinion, because their firm has to give an
5 opinion as to the fairness of the transaction, he was
6 giving, I believe, different scenarios to make sure that
7 the price paid, he could tell the board that the price
8 paid was fair to the existing shareholders.

9 COM. MAYES: Right. Okay.

10 THE WITNESS: It wasn't somebody coming in
11 and saying, "Break it up. Break up the company. Sell
12 off the pieces." It was more making sure that proper
13 valuation was performed to insure that all parties were
14 fairly treated.

15 COM. MAYES: But the original offer from KKR
16 did include spinning it off, correct?

17 THE WITNESS: I think the original offer
18 was, "We give you your choice." It's not, "We're
19 recommending this," because I think they had had
20 conversation with the board, and they felt that there
21 might be some difficulty in coming to a total valuation
22 that the board was comfortable with because different
23 board members had different opinions as to the value of
24 the unregulated assets.

25 COM. MAYES: Okay. Did, well, you touched

1 on the conflict of interest issue, and I know Fennemore
2 Craig did advise you to set up the STAC, the special
3 committee, and I think they also advised several of the
4 board members to recuse, Mr. Aldridge and Ms. Bilby.

5 THE WITNESS: Let me explain, because I
6 think this is germane.

7 COM. MAYES: Okay.

8 THE WITNESS: Fennemore Craig advised that
9 we be Caesar's wife. Liz Bilby is a local member. Her
10 son works for Global Solar, so she recused herself.

11 Larry Aldridge is a local member who is a
12 venture capitalist, local venture capitalist, who before
13 actually he went on the board, UniSource invested
14 \$5 million in his fund that is directed at bringing, or
15 helping venture companies in Tucson. It was what I felt
16 was really something to help the community.

17 Larry Bickle has been on the board for many
18 years. He is not a local member. He gives me counsel
19 on gas direction, et cetera. He was in the business.
20 He has an investment entity that we had invested money
21 in. We've -- most of it is -- we're actually turning
22 over making money on it and selling those assets.
23 That's Haddington Ventures. Now, you might remember
24 that J.P. Morgan -- it might have been testified when
25 you weren't here. J.P. Morgan Chase is also an investor

1 in the Haddington Funds. J.P. Morgan Chase and
2 UniSource were both investors in Haddington Funds.
3 Larry was advised actually by his own counsel that he
4 should not participate, and he has steadfastly not
5 participated, even before Fennemore Craig indicated he
6 should not participate.

7 Finally, the board determined that I should
8 not participate. I should give them advice and counsel,
9 but not participate because even though it was part of
10 my total compensation all along and even though it was a
11 requirement of my job that I invest in the company, they
12 felt that it would just look better if I did not
13 participate in the actual structuring or the actual --
14 because of the profit that I stood to make on my stock
15 investments.

16 COM. MAYES: Okay. So a couple of those, I
17 think at least one of those individuals objected to the
18 recusing. Did they go ahead and recuse, everyone who
19 was advised did recuse?

20 THE WITNESS: Every one of them recused, and
21 every one of them stated that had they not been forced
22 to recuse, after the vote, they would have voted in
23 concurrence with the remaining board members.

24 Now, the remaining board members that were
25 on the Strategic Action Committee were Mr. Carter, who

1 is an independent director from Tucson, had been with
2 IBM and Burr-Brown, was Mr. Handy, who is an independent
3 director from Tucson who was CFO of Kaiser Permanente;
4 was Mr. Elliot who is a local director who has his own
5 accounting firm and is a sports announcer; Mr. Jobe who
6 is a retired CFO of Southern Company and head of the
7 audit committee and brings accounting and financial and
8 utility experience; and Mr. Burlingame who is a retired
9 AT&T individual who gives regulatory, as well as
10 Mr. Jobe, regulatory review.

11 COM. MAYES: Okay. Just turning to the
12 discussion that occurred on October 17th, 2002, at the
13 special board meeting, page 8 and 9, Bates sites 0630,
14 and I discussed this with the panel members. I wanted
15 to run it by you.

16 COM. MUNDELL: 630?

17 COM. MAYES: Yes, 0630, October 17, 2002.

18 THE WITNESS: This is the board of directors
19 meeting?

20 COM. MAYES: Yes.

21 THE WITNESS: Okay.

22 COM. MAYES: October 17th, 630, which is
23 page 8, I think, and this is where the directors
24 inquired of Mr. Hood and Mr. Greene, and Mr. Greene is
25 from Thelan Reid, whether the board had a duty to the

1 company's customers when considering the merger.
2 Mr. Greene responded, I am reading directly, that "The
3 board's duty is to shareholders and the regulator's duty
4 is to customers. However, the board does have to
5 evaluate the potential success of this transaction, and
6 have to take customers and whether the transaction will
7 be found by regulators to be in the public interest into
8 consideration in evaluating the likelihood of the
9 transaction receiving regulatory approval. Mr. Fesler
10 inquired as to whether the director of a regulated
11 entity holding a franchise has a different duty.
12 Mr. Hood and Mr. Greene noted that under state
13 corporation statutes and other jurisdictions, directors
14 are permitted to consider constituencies other than
15 shareholders. However, the Arizona corporate statute
16 does not contain such a provision. Mr. Fesler indicated
17 that he believes it is incumbent upon a board of a
18 public utility to consider the interests of its
19 customers in any such transaction. The board then
20 discussed the customer implications of the potential
21 transaction."

22 I would certainly agree with Mr. Fesler, and
23 he is a member of your board or not?

24 THE WITNESS: He had to leave the board, but
25 I have his advice and counsel continuously. Mr. Fesler

1 was a professor of law in California, then he was head
2 of the California Public Utilities Commission. He then
3 went and was an attorney for LeBeauf Lamb, and just at
4 the time when all this was happening, he had been under
5 pressure from his partners at LeBeauf Lamb because he
6 was spending too much time with us and not getting any
7 billing hours, which we can't do. And he went with
8 Holland Knight, or maybe McKnight, Holland Knight,
9 mainly out of Washington, and he just felt it was too
10 much of a conflict with his time, so he did not feel he
11 could give adequate assistance to the board and tendered
12 his resignation, which I reluctantly accepted.

13 But I don't have those actual minutes before
14 me, but I think if we continue along in the trend of
15 those board meetings, it becomes very obvious that this
16 board really looked at the total constituent package,
17 almost total constituent package which I mentioned in
18 the first day I was testifying: The consumer, the
19 community, the company, the regulator. They looked at
20 all of that, because even though Mr. Greene, and I think
21 he specifies that I'm giving you the strict legal
22 analysis, even though Mr. Greene did that, even Reid &
23 Priest said, "You are imbued with public interest, and
24 you have a higher standard. Now, if you can maximize
25 the value to your shareholder in conjunction with

1 meeting the needs and providing benefits and providing
2 current benefits to all the other parties, including the
3 consumer, very highly the consumer, probably most
4 importantly is the consumer, then you are meeting your
5 standard, that the strict legal interpretation of the
6 law does not overcome our obligation to provide safe,
7 reliable service at fair and reasonable price.

8 COM. MAYES: I don't necessarily read the
9 same thing into what Mr. Greene and Mr. Hood were saying
10 there, but --

11 THE WITNESS: They were just --

12 COM. MAYES: -- but they're lawyers.

13 THE WITNESS: They were giving the strict
14 legal interpretation, and if all of the discourse in the
15 meetings was here in the minutes, you would see that
16 conclusion. If they didn't come to it, they didn't stop
17 the board as the board came to it.

18 COM. MAYES: Well, speaking of that, the
19 last line in this passage says, "The board then
20 discussed the customer implications of the potential
21 transaction." Do you know what was said there? I
22 don't know if you were in on this meeting, but what were
23 the customer implications? I assume they discussed
24 potentially negative customer implications as well as
25 positive ones.

1 THE WITNESS: No, I think it was more is
2 there any impact on revenue requirements as a result of
3 this transaction. The answer is no, and Mr. Glaser
4 advised, you know, we have frozen rates through 2008
5 with a rate check in 2004, but this transaction does not
6 impose any additional costs into that structure. In
7 fact, with the exception of going immediately to the
8 40 percent equity which pushes revenue requirement up
9 because the cost of capital goes up a little bit, I'm
10 sure, that is there any negative implication on quality
11 of service, and the answer is no, there's no negative
12 implication. In fact, there are benefits to quality of
13 service because they said, "These people have to commit
14 that they will provide the resources that at a minimum
15 maintains our current high quality of service." And if
16 I could read that board over there, in the merger
17 agreement stipulated conditions, item VI and VII were
18 part of my recollection that the board required go into
19 the purchase agreement.

20 COM. MAYES: Okay.

21 THE WITNESS: They wanted commitments that
22 they were not turning this company over to anyone who
23 was not prepared to maintain and provide the capital
24 necessary to maintain the reliability of service and to
25 meet our CC&N obligation to provide safe and reliable

1 power to everybody who moves into our territory.

2 COM. MAYES: Commissioner Mundell wants to
3 jump in here, but let me quickly ask you, where did you
4 come up with, and maybe this has been asked and
5 answered, but where did you come up with the 1. --

6 THE WITNESS: 1.5 billion?

7 COM. MAYES: Yes, that figure.

8 THE WITNESS: Those were the total numbers
9 of O & M and capital that were in my forecasts which
10 were provided to the investors for their economic
11 analysis and provided to the Staff. And the Staff in
12 working together said that, okay, if we take what had
13 been the company's prior budget and memorialize this as
14 a condition going forward so that the Commission has the
15 ability to insure that those funds are expended, right
16 now, you don't have my budget. You don't have my
17 capital expenditure. You can call me and show cause if
18 I'm not meeting my service obligation, but now these
19 numbers are there, and if we're not meeting them, you
20 can call me in and call the investors in. You have a
21 commitment here. Why aren't we doing this?" You don't
22 have that power right now. This is an added power to
23 you.

24 COM. MAYES: But the \$1.5 billion was not
25 arrived at in conjunction with either RUCO or Staff or

1 anyone else. That was just something that you arrived
2 at, correct?

3 THE WITNESS: We, I think the way it
4 transpired was the Staff witness said, you know, "You
5 need to insure reliable service." And we came back to
6 the Staff in my testimony and said, "We've taken all our
7 budget and added it up, and it's the budget that you
8 have in front of you. It's not some altered, doesn't
9 include any cuts or anything like that. It's what we
10 anticipated before the merger, and we're committing to
11 hard dollars in that amount."

12 That's how it came up. I'm not going to say
13 we negotiated it with the Staff. We proposed it in my
14 testimony, and I just wanted to give you the basis of
15 where it came from.

16 COM. MAYES: Okay.

17 Go ahead.

18 COM. MUNDELL: Thank you. Thank you,
19 Commissioner.

20 Mr. Pignatelli, I was going to have you go
21 through, maybe from a time perspective I won't do it,
22 but looking at all the conditions, you've heard RUCO say
23 the other day that most of the conditions, I think 16 or
24 17 out of the total number of conditions, are already
25 required by statute, rule, or case law. Tell me which

1 ones of the conditions are not, are already required by
2 statute, rule, or case law.

3 THE WITNESS: Could I file that with you
4 later? I don't know that I can go through and --

5 COM. MUNDELL: That's fine, in the interest
6 of time. But the point is, as I said the other day,
7 initially it looked like you were agreeing to all these
8 conditions, at least from my perspective. And what I
9 read in the newspaper again, "UniSource agrees to all
10 these conditions," but it looks like they're already,
11 based on RUCO's testimony, I wanted to give you an
12 opportunity to contradict that or supplement it, are
13 they already required by case law, statute, or rule?

14 THE WITNESS: I can go through --

15 COM. MUNDELL: No, you can supplement it.

16 MR. HEYMAN: Excuse me, Commissioner Mundell
17 and Mr. Pignatelli, I would prefer to deal with this in
18 our brief because we disagreed with RUCO's position and
19 for the assumption in your question that in fact there
20 are requirements.

21 COM. MUNDELL: That's why I asked the
22 question.

23 MR. HEYMAN: And I appreciate the question.
24 I am just saying rather than having Mr. Pignatelli do it
25 on the spot, and I know he would prefer to do it, on

1 advice of counsel, he is going to wait for the brief.

2 COM. MUNDELL: That's fine. And that will
3 work out well, and we can have some discussion in
4 briefing on those issues.

5 MR. HEYMAN: Thank you.

6 COM. MUNDELL: Let me read Mr. -- I think
7 Staff reaches a conclusion in their testimony on whether
8 or not there are any benefits as a result of this
9 transaction, if I could find it. But it really
10 contradicts I think your conclusion.

11 I'm wondering, you said earlier you don't
12 know how Staff really feels on the benefits. Well, I
13 guess they really feel about the benefits what their
14 testimony shows. So I wasn't sure what that response --
15 I mean, I wrote it down, you said, "I don't know how
16 Staff really feels about the benefits. They've
17 indicated that they don't see any immediate benefits."

18 THE WITNESS: Is that a question? The way
19 I look at it is I think Staff agrees there are benefits.

20 COM. MUNDELL: Let me just interrupt because
21 I found what I was looking for. I'm looking at the
22 executive summary from Mr. Antonuk's surrebuttal
23 testimony. I will read you that last -- do you have it
24 for him, Mr. Heyman?

25 MR. HEYMAN: I do.

1 COM. MUNDELL: It's the last paragraph.
2 Mr. Antonuk's testimony concludes by stating, "The
3 adoption of the changes and conditions expressed in this
4 testimony would persuade Staff that there have been
5 adequate mitigation of risks under the acquisition as
6 proposed. He observes, however, that the acquisition
7 would not provide any discernible immediate price,
8 quality, or reliability of service benefits to
9 customers. It would, however, provide immediate
10 benefits to shareholders in the form of a stock
11 premium."

12 I've heard you --

13 MR. HEYMAN: Mr. Commissioner, that is not
14 the last sentence we have. On the witness summary?

15 COM. MUNDELL: Well, I will read it again.
16 What I have -- maybe there is another one. "It would,
17 however, provide immediate benefits to shareholders in
18 the form of a stock price premium."

19 MR. HEYMAN: We don't have that on the
20 one --

21 ALJ RODDA: Yes, that is the executive
22 summary that is at the beginning of --

23 MR. HEYMAN: Oh, not the witness summary?

24 COM. MUNDELL: That's what I said. I said
25 it was the executive summary of his surrebuttal, I

1 thought I did, but maybe the court reporter could read
2 back what I said.

3 MR. HEYMAN: That's okay. They're two
4 separate documents.

5 COM. MUNDELL: I will ask the question,
6 Mr. Pignatelli. That contradicts sort of your long
7 dissertation about all the constituencies that are going
8 to be benefiting from this.

9 THE WITNESS: Sir, I don't agree with Staff.

10 COM. MUNDELL: Okay.

11 THE WITNESS: I guess that's -- and I think
12 that maybe there's overreading on what Staff is saying.
13 And I want to say that the standard even Staff has
14 applied has sort of changed in their testimony over
15 time. The standard no harm, then public interest,
16 benefits, and we've shown benefits, then current
17 benefits, and I think financial stability, I think
18 management continuity, I think --

19 COM. MUNDELL: Yes, I --

20 THE WITNESS: Could I, please?

21 I think presence, I think community
22 activity, I think the conditions, the hard conditions
23 which guarantee certain levels of O & M expenditures. I
24 think there are -- we're not giving the sleeves out of
25 our vest in these. There are many additional

1 conditions. The ring fencing that goes in, the benefits
2 to the state are current benefits. I disagree that then
3 we take the next statement and make current benefits
4 only equate to dollar savings. There is nothing in
5 benefits which says it is dollars, and I disagree with
6 the concept because the value to the customer that is
7 current is that electricity when he flips that light on.
8 That's what's of value.

9 And I disagree with the concept that this
10 premium is all of a sudden such a great windfall to the
11 shareholder. I gave you the cite, I've invested more
12 than 100, but if I take \$100 a year for 10 years, that
13 is an 8 percent return with this windfall premium.

14 COM. MUNDELL: Okay. My only question was
15 that Staff disagrees with your conclusion. That --
16 because you, like I said you initially said, I wrote it
17 down, you said, "I don't know how they really feel about
18 the benefits." They've testified how they feel, what
19 their position is.

20 THE WITNESS: In making that statement, I
21 know that the Staff recognizes the benefits.

22 COM. MUNDELL: Okay.

23 THE WITNESS: In making that statement, I
24 don't know what the Staff feels are current benefits.
25 We may differ, just as you and I may differ on it.

1 COM. MUNDELL: Let me shift gears. There
2 was a presentation, and I mentioned it I think when I
3 was asking the panel about a presentation that was made
4 to the board where they talked about what would happen
5 if there was a rate freeze, a rate reduction, or market
6 rates, but there was no discussion about a rate
7 increase. If you're entitled to a rate increase this
8 year, as you said, a 16 percent, why wasn't there a
9 discussion post going forward 2008? Why wasn't there
10 analysis done of that?

11 THE WITNESS: Actually, there was --

12 COM. MUNDELL: In the minutes, it only says,
13 I will have to find it, it says rate freeze, rate
14 reduction, or market. I thought it said competitive
15 rates.

16 THE WITNESS: I think that the market, the
17 competitive market is the rate increase. There was no
18 discussion on where we are today because we have the
19 frozen rate. So when you look out after 2008, the board
20 looked at the potential trajectories of value of the
21 company assuming a rate freeze, a rate reduction, and
22 then a case involving taking generation to market which
23 is the current rate path that we're under.

24 COM. MUNDELL: Why would they do analysis of
25 a rate decrease under current scenario, existing

1 scenario and not do a rate increase if there was, based
2 on your review of your records? I'm having a hard time
3 understanding that.

4 THE WITNESS: Sir, what they are looking at,
5 what I am saying is that market is a rate increase. And
6 I think you'll see at that point in time in those
7 minutes, I make the statement that in equity, I do not
8 believe that going to market, complete market, would be
9 permissible. It was not something that I would even
10 push with the Commission because it resulted under the
11 assumption where the market cost of energy is in 2008 a
12 fully deregulated case presents returns which I felt
13 were perhaps too high. That's --

14 COM. MUNDELL: So the deregulated market
15 would result in rate increases?

16 THE WITNESS: Yes, sir. If you take the
17 price of power out in 2008, the price of power out in
18 2008 is probably in the \$60 range, 50, \$60, wherever gas
19 prices go. The price of power included in our current
20 rates is more in the 4.8 cent or \$48. So a fully
21 deregulated case, even though that is our current
22 status, vis-a-vis our settlement, I don't think is, will
23 result, and I have so advised the board.

24 COM. MUNDELL: Do you think it would be fair
25 as they've done in Oregon to tie some kind of rate

1 credit to the profits that the buyer is going to make?

2 THE WITNESS: No, sir.

3 COM. MUNDELL: They are doing it in Oregon,
4 but you don't think it would be fair in this case?

5 THE WITNESS: Sir, I think that the
6 situation in Oregon is completely different because you
7 are taking, the buyers are taking something out of
8 bankruptcy. And I don't know all of the distinctions,
9 but I can tell you that the ratepayer is benefiting
10 tremendously right now because we bought Citizens at
11 much less than the cost on their books. Their
12 shareholder lost tremendous amounts of money. I think
13 what the Commission needs to focus on is in their rate
14 reviews when appropriate what is the cost of capital
15 necessary to provide safe, reliable service with a
16 reasonable profit.

17 COM. MUNDELL: Okay.

18 THE WITNESS: And that is not a function of
19 what the investor does in the marketplace. If I invest,
20 if I invested the day before the transaction was
21 announced and then I got a 30 percent return, I made a
22 good market decision. It's no different -- we had the
23 hypothetical on the house, and when a home buyer goes in
24 to buy a house, they don't ask the other home buyer or
25 home seller what their return on their investment is and

1 adjust the price accordingly.

2 COM. MUNDELL: They also, though, to use
3 your house analogy, you know, have an inspection that's
4 done and provided. And in this case, we know Ernst
5 & Young has done some kind of inspection, and so you can
6 take that house analogy in other directions. But I
7 appreciate that.

8 What I would like to do is have the
9 testimony of Mr. Davis in the Portland Utility case
10 marked as an exhibit and entered into the record here
11 where they talk about tax rate credits and they also,
12 even though I know your counsel has said this is not and
13 you have had said it's not about demand side or
14 renewables, in that case in Oregon they are talking
15 about this. I would like this marked as Mundell No. 2,
16 and it discusses the tie-ins and rate credits and the
17 profits that the buyers are going to make.

18 Then before I forget, Your Honor, I actually
19 have the Order from the Oregon judge; I just can't find
20 it. But I will put it into the record next week, not
21 just the summary of the letter that was marked as an
22 exhibit. But I want to just make sure that I put that
23 on the record. I actually have the Order, and I will
24 have it marked next week and put it into the record.

25 You know, at one time, Mr. Pignatelli, it

1 was the position of management that both the Citizens
2 purchase by UniSource and this merger should occur at
3 the same time. Why did that change?

4 THE WITNESS: Should not occur at the same
5 time?

6 COM. MUNDELL: Should occur, or could occur.

7 THE WITNESS: I don't believe that was the
8 position of management. In fact, I broke off any
9 discussions while we were prosecuting Citizens. So I
10 don't know, unless you have some --

11 COM. MUNDELL: Well, it's in the minutes
12 somewhere. I just need to find it.

13 COM. MAYES: On October 17th, page 9 -- oh,
14 no, I'm sorry. Either October 17th or September 16th --

15 COM. MUNDELL: You can jump in if you want
16 to and I can try to find it.

17 COM. MAYES: I was going to ask about this
18 as well. On September 16th, 2002, page 2, looks like
19 the board wanted to know whether it would be possible to
20 acquire Citizens' assets and do a deal with J.P. Morgan
21 simultaneously. Do you recall that?

22 THE WITNESS: No, I don't recall that, but,
23 because we didn't have any offer from J.P. Morgan at
24 that point in time. We had just signed a confidential,
25 confidentiality on July 19th, so I do not recall the

1 circumstances of that September 16th, or whatever. But
2 on October 29th, we executed an agreement to acquire
3 Citizens, and in November of 2002, and I don't know what
4 date, but within the next week, I advised the group,
5 J.P. Morgan, that I did not want to discuss any
6 acquisition at this time because I was in the process of
7 acquiring another piece of property.

8 COM. MAYES: Well, yes, and on October 17th,
9 it says, "The Chairman asked the board to indicate
10 whether they wanted to continue discussion with the
11 J.P. Morgan Group or to advise the J.P. Morgan Group
12 that the company is not for sale. Mr. Bickle at this
13 point recused himself. After the discussion, the board
14 indicated that the company should continue its
15 discussions and to provide explanation to the
16 J.P. Morgan Group. The board, however, also reached a
17 consensus that it did not want the expiration of the
18 transaction with the J.P. Morgan Group to adversely
19 affect the Citizens transaction and expressed its desire
20 to know of any obstacles that a possible transaction
21 with the J.P. Morgan Group might present with respect to
22 the completion of the Citizens acquisition."

23 THE WITNESS: This is consistent with my
24 recollection. I, I had said very positively that the
25 acquisition of Citizens was important to our

1 shareholder, was important to the company, was important
2 to the state, and that I did not want anything to
3 interfere with that, either from management, time, or
4 anything else. And so that's why I say, in November,
5 immediately after we executed an agreement to acquire
6 Citizens, I told the investor group that we were
7 terminating all discussions. And it's not that we had
8 any offer in front of them; it's just that they wanted
9 to do due diligence. And I said, "No, I don't want you
10 around. We're working on other things."

11 COM. MUNDELL: Can I jump back in,
12 Commissioner Mayes?

13 COM. MAYES: Sure.

14 COM. MUNDELL: It's 0592, 0592, and it says
15 Mr. Pignatelli indicated that the management's intention
16 to seek the approvals contemporaneously and that the
17 complexity of doing so would not prevent both
18 transactions from being approved.

19 THE WITNESS: I changed my mind. I changed
20 my mind in November and said, "No, I don't want to do
21 it."

22 COM. MUNDELL: Counsel, Mr. Heyman, I can't
23 find where there are minutes that talk about why the
24 change occurred. If there's some point in time in your
25 brief if you can certainly point that out to us.

1 You've indicated that you should do them
2 both at the same time, it was your position to do it,
3 and at some point in time, it changed.

4 THE WITNESS: I know. I changed my mind in
5 November. I just said, "It's just too much trouble and
6 the Citizens is too important."

7 COM. MAYES: Mr. Pignatelli, was the
8 Corporation Commission -- this is before my time on the
9 Corporation Commission. Was the Corporation Commission
10 at the time that it was deciding the Citizens case aware
11 of your discussions --

12 THE WITNESS: My prior discussions which had
13 been terminated? No, they were not aware of them.

14 COM. MAYES: And they were not aware you
15 were also at least contemplating this deal at that time?

16 THE WITNESS: We weren't contemplating any
17 deal at that time. From November, in November, the
18 buyers were not at a price position. Even if you would
19 have asked them they would have told you, "We didn't see
20 how a deal would be consummated." I think that was
21 actually asked, because they came back because the
22 interest rates were down. They could do, they had a
23 better, we were a better alternative than other
24 investments at that point in time. But not only was
25 there nothing that was really active, but I felt that

1 there were two things that were more important:
2 Completion of Springerville, and acquisition of
3 Citizens. And I saw what my organization was having to
4 go through on due diligence on each one of those, and I
5 said, "We cannot handle a due diligence with regard to
6 any sale." Did I come to the Commission and tell them
7 that there was, had been discussions, and I had
8 terminated them? No.

9 COM. MAYES: Well, but, I mean, your board
10 is discussing at this time entering into an exclusivity
11 letter. That seems pretty serious to me.

12 THE WITNESS: We had signed a
13 confidentiality and executed a due diligence agreement
14 in September 16th, we executed a due diligence
15 agreement. October the 29th, I executed an agreement to
16 acquire Citizens. November, I terminated the due
17 diligence agreement with J.P. Morgan. I said, "We're
18 not in." I don't know if we formally terminated it. I
19 said, "Don't bother us. We're not talking. I have
20 other things that have to get done." It's as simple as
21 that. Strategy I felt was much more important for the
22 company to do the Citizens and the Springerville.

23 COM. MUNDELL: Could you define the term
24 acquisition for me?

25 THE WITNESS: Acquisition?

1 COM. MUNDELL: Uh-huh.

2 THE WITNESS: One party acquires the other.
3 That's an acquisition, I guess. It's somebody acquiring
4 the legal right to either a piece of paper or --

5 COM. MUNDELL: Would that include buying or
6 selling?

7 THE WITNESS: Well, if you're an
8 acquisition, you're buying. It depends on whether
9 you're the acquiree or the acquirer.

10 COM. MUNDELL: Okay. Let me go back to my
11 question I asked you earlier in the week. On May 1st,
12 2003, in the Citizens hearing, evidentiary hearing,
13 Mr. Holub asked you, "Have you had any discussion with
14 anyone about selling any portion of these assets after
15 you get approval from the Commission to take them over?"
16 And your answer was, "Yes, you," meaning City of
17 Nogales. And then he asked a follow up, "Anybody else,"
18 and you said no.

19 THE WITNESS: And I still would say no, sir.
20 I am not -- we're not selling assets here. We're, the
21 stockholder is selling their interest in our company.

22 COM. MUNDELL: So the question --

23 THE WITNESS: And if the question there --
24 the next day probably 100,000 shares of my stock sold.
25 Is that the sale of an asset? No, it's not.

1 COM. MUNDELL: Well, these assets are
2 involved, the UniSource Electric and Gas are the assets
3 he's talking about. They're involved in this
4 transaction, correct?

5 THE WITNESS: Yes.

6 COM. MUNDELL: Okay.

7 THE WITNESS: But we're not selling assets.

8 COM. MUNDELL: I understand. So as I said
9 the other day, you narrowly answered the question when
10 you were asked it. Is that a fair statement?

11 THE WITNESS: No, sir.

12 COM. MUNDELL: Okay.

13 THE WITNESS: I did not narrowly answer that
14 question. I did not narrowly read that question. I'm
15 not selling these assets. I'm not breaking these assets
16 up. That was the question that Mr. Holub asked me.

17 COM. MAYES: Mr. Pignatelli, can you
18 understand how some people in some of your service
19 territories who have experienced extremely high rate
20 increases recently including, you know, Prescott,
21 Arizona, Mohave County, why they might see that as a
22 distinction without a difference, why they might have
23 thought it would be relevant to this Corporation
24 Commission at the time it was making a decision about
25 the sale of Citizens to UniSource to know that UniSource

1 had just been in talks about, you know, going through
2 this, whatever you want to call it, merger, sale, even
3 if it's not a sale of "assets," how they might have
4 thought that that would be relevant? Because I can't
5 see how it wouldn't be, quite frankly.

6 THE WITNESS: Actually, I respectfully
7 disagree with your conclusion there. The transaction --
8 what they should have been concerned about is the sale
9 of an asset to a different management group, different
10 company that was going to come in. That's not
11 happening. The -- I lost my train of thought. I'm
12 sorry, there was another point that was the most
13 pertinent one. Maybe I'll pick it up another time.

14 COM. MAYES: But can't you see how, you
15 know --

16 THE WITNESS: I remember.

17 COM. MAYES: I will let you respond, but
18 can't you see how the average Joe or Judy as my
19 colleague sometimes puts it would want to know if, you
20 know, you are engaged in talks of selling, merging the
21 whole company at the same time that their particular
22 aspect is being merged into yours?

23 THE WITNESS: Actually, quite the contrary.
24 If they're investors, that would make them insiders.
25 There's tremendous liability with disclosure, tremendous

1 liability, especially when I don't have any offers.

2 COM. MAYES: How about just to the
3 Corporation Commission which is going through the
4 process of making this decision?

5 THE WITNESS: See, and that's maybe where I
6 disagree with your premise, because we weren't going to
7 sell off any assets. We were going to still manage
8 them. The prices which you characterized as high I
9 won't take exception to at this point in time. The
10 price increases were being driven by things of which we
11 had no profit in. They're driven by energy pass
12 through. The return, the return on the investment was
13 established by the Commission on the gas side because it
14 was in a rate proceeding. The return on the electric
15 side was not subject, but, so it remained at its lower
16 amount.

17 The acquisition, we acquired the property at
18 lower cost than book and gave a tremendous benefit to
19 the ratepayers, the consumer, but the fact that the
20 rates are established in a vacuum with regard to
21 ownership is really a protection. It doesn't make any
22 difference who the owner is because you have the
23 authority to determine what the reasonable return is,
24 not based on trading in the stock market, but based on
25 what you believe is appropriate cost of capital and the

1 appropriate return on capital invested and dedicated to
2 utility service. Who owns the entity, as long as they
3 don't interfere with your regulatory oversight, with the
4 management, with the safe and reliable service, you
5 should be indifferent to.

6 COM. MAYES: Well, I totally disagree with
7 you. I mean, this is just, maybe it's a philosophical
8 difference, but I think it makes all the difference in
9 the world. And if it didn't, you wouldn't be making the
10 argument to the community here that they ought to accept
11 KKR because somebody else with a blacker hat might swoop
12 in and take over the company. It makes all the
13 difference in the world. That's what the case is about.

14 THE WITNESS: And that's why we have all
15 these conditions which prevent the black hat from
16 swooping in. I haven't gone into this lightly. I live
17 in this community. I wouldn't sell this community a
18 bill of goods. I wouldn't sell you a bill of goods.

19 COM. MUNDELL: Let me shift gears on the
20 same issue. You don't think it would have been
21 important for the Commission and the Commissioners to
22 know that this transaction, because you referred to it
23 as a merger and sale today, you said today, "I wish we
24 hadn't called it a merger. I wish we would have called
25 it a sale." The people out there aren't making these

1 subtle distinctions you are making. That's what
2 happened. But having said that, don't you think it
3 would have been important for the Commission to know, A,
4 you were in negotiations and the benefits that you
5 described in this particular transaction, lower cost of
6 capital and access to a capital infusion, you don't
7 think that would have impacted or at least we should
8 have been aware of that?

9 THE WITNESS: We weren't in negotiations at
10 the time of Citizens. We had broken off, so I don't
11 know what point in time you are referring to.

12 COM. MUNDELL: Well, the question -- I am
13 not going to repeat it. It said have you been in any
14 discussions. It wasn't asked specific enough I guess
15 and it wasn't, you know, you've indicated because he
16 used the word sale of assets --

17 THE WITNESS: Sir, I was not dancing on the
18 head of a pin. I understand the consequence and I
19 understand the meaning of words, and I don't play games
20 that way. I don't. When we were taking the Citizens
21 transaction through the Commission, we were under no
22 active discussion about the, any transaction involving
23 UniSource stock or any of its assets. I terminated them
24 specifically. I terminated them specifically.

25 COM. MUNDELL: Well, I guess your answer

1 will speak for itself.

2 Let me shift gears. I asked you the other
3 day and read from the minutes, you said most of the
4 workers are protected, and I said the corollary of that
5 is some aren't. And you gave me a very detailed answer
6 about how you didn't want to let everybody know that
7 they had a guaranteed job, et cetera, et cetera, and I
8 understand that. I should have followed up with the
9 question, and just to make it clear, notwithstanding
10 that answer, there are no planned layoffs, yes or no?

11 THE WITNESS: That's correct, there are no
12 planned layoffs.

13 COM. MUNDELL: Okay. And there has been no
14 analysis done or studies or, you know, business plan to
15 lay off any employees post-merger?

16 THE WITNESS: There is no plan to lay off
17 any employee post-merger, and I would like to note that
18 we just signed the contract, bargaining contract with
19 all the locals which Mr. Enoch represents, and our
20 largest union, Local 1116, just submitted a letter to
21 the Commission indicating their support of the
22 transaction.

23 COM. MUNDELL: Let me shift, unless you have
24 a question.

25 COM. MAYES: Just a quick follow up. Then

1 there are no plans, I assume, to engage in outsourcing
2 of any kind?

3 THE WITNESS: There are no plans to engage
4 in outsourcing of any kind.

5 COM. MAYES: No changes in health care
6 benefits?

7 THE WITNESS: No changes in health care
8 benefits or pensions.

9 COM. MAYES: Okay.

10 COM. MUNDELL: How much of the generation at
11 peak is from coal? We talked about 90, 91 percent the
12 other day.

13 THE WITNESS: That's total energy.

14 COM. MUNDELL: That's right. That's why I
15 asked it differently.

16 THE WITNESS: Our peak this year is probably
17 going to be a little over 2,000, depends on how hot it
18 gets, but basically a little over 2,000 megawatts,
19 probably closer to 2,100 megawatts. And my recollection
20 is if all our coal is running on peak, we're producing
21 plus or minus about 1,600 of those megawatts. So on
22 peak, we're buying, either running our gas or buying
23 from the marketplace, and on Track B about 500
24 megawatts. We do have, before I say it, 110 megawatts
25 of that 500 is supplied through an Edison exchange, so I

1 would have to reduce it, but I don't know how much we
2 have that is not included in that 2,100 that might be
3 going, we supply to the Indian Nation. But just say
4 plus or minus 4 to 500 megawatts.

5 COM. MUNDELL: Thank you.

6 Could you hand that to Mr. Pignatelli, and
7 then I have some for counsel.

8 I guess we will have this marked as Mundell
9 No. 3. I will give you a chance to look at it. It's
10 from C.A. Turner Monitor and Output Outlook.

11 THE WITNESS: Okay.

12 COM. MUNDELL: To make it easy, I think you
13 can see there are little check marks where it says
14 UniSource Energy Corporation, it's in the middle of the
15 exhibit right at the top there.

16 THE WITNESS: I'm sorry, which -- I was
17 thinking when you asked me something.

18 COM. MUNDELL: In the middle.

19 THE WITNESS: Ten highest and lowest
20 combinations?

21 COM. MUNDELL: Correct. And on the top it
22 says UniSource Energy Corporation, and it is listed as
23 having the highest growth rate for the next 12 months
24 for the period ending August of 2003. Do you see that?

25 THE WITNESS: Yes, sir.

1 COM. MUNDELL: And then in the middle there
2 where that's for the next five years, it's got
3 UniSource, 10 percent growth rate, and it has the
4 numerical number 1.

5 THE WITNESS: Right.

6 COM. MUNDELL: And so this seems to indicate
7 that UniSource was in pretty good shape back in August
8 of 2003. Would you agree with that? I mean, just this
9 outlook here. It has dividend safety rank and also
10 projected growth. Am I reading this correctly?

11 THE WITNESS: I'm trying to figure out what
12 it is. Annual dividend growth rate and related dividend
13 safety rank; I can't speak to the ranking. I think that
14 their projections of our dividend growth rate is a
15 little high. I don't think my board is going to
16 authorize a 13 percent increase. But you're only
17 focusing on one small aspect, and that's dividend
18 growth. And don't forget, we have not -- we only
19 reinstituted dividends four or five years ago. So we
20 started from a very low point, and our growth rate might
21 be high in relation, but this is higher than I would
22 anticipate. And I think you have to realize we are also
23 starting from a low point.

24 Sir, and I need to modify my prior answer.
25 I was thinking about the answer on the peak, and I left

1 out UES because I don't remember whether you asked me
2 TEP, but I have to buy about 400 megawatts on peak at
3 UES. So I'm short about 800 to 900 megawatts on peak
4 where that comes from other than coal.

5 COM. MUNDELL: I appreciate that
6 clarification, because I started to indicate, and then I
7 think I just completed my question.

8 Well, in any event, this can be marked as
9 No. 3 and have it admitted into evidence and it will
10 speak for itself.

11 THE WITNESS: Sure.

12 COM. MUNDELL: And I asked you a question,
13 it looks like the industry to me thinks that UniSource
14 is in pretty good shape back in August of 2003.

15 THE WITNESS: Sir, all this, this doesn't
16 have anything to do with the --

17 COM. MUNDELL: Okay.

18 THE WITNESS: -- relative strength of the
19 company.

20 COM. MUNDELL: Okay.

21 THE WITNESS: This only has to do with
22 dividend growth. Doesn't talk about bond ratings,
23 doesn't talk about returns, doesn't talk about
24 regulatory environment, doesn't talk about anything.
25 This is a very minimal aspect.

1 COM. MUNDELL: Okay. It's one aspect. I
2 agree with you.

3 THE WITNESS: It's not even an aspect of
4 strength. This is only an aspect of what the board
5 feels comfortable in dividending as a current return to
6 shareholders. Has nothing to do with the strength of
7 the underlying business.

8 COM. MUNDELL: Okay. Thank you.

9 COM. MAYES: If I could just jump in there,
10 the Morgan Stanley analysis of, the Morgan Stanley
11 preliminary valuation analysis which is contained within
12 the November 18th, 2003 minutes of the special meeting
13 of the board of directors, page 5, I think it was
14 Mr. Moore indicated that according to Morgan Stanley's
15 analysis, the company is trading fairly in the market in
16 relationship to comparable companies. Doesn't that
17 indicate a healthy company? I mean, are you saying the
18 stock market is wrong?

19 THE WITNESS: Read the last part of that
20 sentence.

21 COM. MAYES: "Trading fairly in the market
22 in relation to comparable companies."

23 THE WITNESS: Comparable companies,
24 comparable noninvestment grade companies of our size.
25 That doesn't have anything to say vis-a-vis the

1 company's relative financial strength. It just says
2 it's trading fairly with regard to comparable companies.

3 COM. MAYES: Well, okay.

4 COM. MUNDELL: Tell me again, Mr. Moore was
5 with Morgan Stanley?

6 THE WITNESS: Yes, sir.

7 COM. MUNDELL: Okay. It's hard for me to
8 read, but it looks like 00552 --

9 THE WITNESS: Yes, sir. I don't have it.

10 COM. MUNDELL: I will read you the quote and
11 maybe you can address it. "Mr. Moore indicated that
12 projected rate of return for the buyers based on the
13 current financing plan and current price was within a
14 reasonable range for investment buyers." So was there a
15 presentation made to the board on what the projection
16 for the rate of return for the buyers was?

17 THE WITNESS: I believe that Mr. Moore made
18 a presentation. I was not at that, but I think what
19 needs to be kept in mind is something that the buyers
20 told you, and that is that the dividends come up out of
21 TEP to UniSource are only going to, or the vast majority
22 is going to pay interest and current, excuse me, retire
23 debt, that there is no significant current return in
24 those years. And the buyers are really dependent, their
25 return is dependent on the multiple earnings that, or

1 EBITDA, earnings before interest, tax, and depreciation,
2 that they will ultimately in 8 to 12 years receive from
3 the market. They are completely at risk on their
4 return, and the multiple which they will receive from
5 the market is a function of them and us, me, being able
6 to keep constructive relationships with this Commission
7 and to provide safe and reliable service. They are
8 100 percent risk. Anything that is estimated to be
9 their return is purely a projection, and it's purely
10 dependent on market conditions in 8 to 12 years, and we
11 don't set rates on market conditions.

12 COM. MUNDELL: Well, I guess what I was
13 confused about is I thought they hadn't -- well, I'll
14 strike the question.

15 THE WITNESS: This is the independent
16 advisor to the Strategic Advisory Committee making an
17 assessment of theirs. This is not something that came
18 from the buyers.

19 COM. MUNDELL: I understand.

20 THE WITNESS: They don't even trade it among
21 themselves.

22 COM. MUNDELL: I understand it's Morgan
23 Stanley who is advising the Transaction Committee. Is
24 that some of the information that was disclosed?

25 MR. HEYMAN: I believe that we provided to

1 you the Morgan Stanley presentation on November 18th.

2 It starts with Bates stamp number 4443.

3 COM. MUNDELL: Thank you. I was trying to
4 find it. I promise I have just one or two more
5 questions on that.

6 THE WITNESS: I was going to ask for a
7 bathroom break.

8 ALJ RODDA: We need a break soon if we are
9 going to go too long.

10 COM. MUNDELL: I have just one other line of
11 questions on the tax issue in Oregon. I read the
12 Judge's order and I read the letter you all submitted,
13 and I said I will submit the actual order into the
14 record next week sometime when I can find it again. The
15 issue there was was there fraud committed by the
16 company, you know, going, sort of looking backwards at
17 what they collected and what they sent on to the holding
18 company. My issue is a little different. My issue is
19 looking, going forward, whether or not taxes will be
20 collected based on the stand-alone analysis that you
21 said has been traditional, and whether or not when those
22 taxes are sent to the holding company, whether they'll
23 actually be paid or not. And that's the -- the judge
24 didn't -- if you read it closely, he made the
25 distinction between looking backward as to whether fraud

1 had been committed based on an order that the Oregon
2 Commission had issued. But I am looking at it
3 differently. I am looking at it going forward and
4 whether or not the way we've always looked at taxes
5 should remain that way.

6 THE WITNESS: Sir, I will respectfully
7 disagree with your reading of that. I think the Judge
8 remanded it on the fraud issue --

9 COM. MUNDELL: Right.

10 THE WITNESS: -- but he reinforced that the
11 appropriate treatment was the stand-alone basis. Now,
12 implicit is that is a going forward stand-alone basis.
13 Now, I am firmly committed, I firmly believe that the
14 stand-alone basis is the correct way to do it, and that
15 is, I'm not going to say almost universally, because you
16 would pick on that language, but I would say --

17 COM. MUNDELL: Not me.

18 THE WITNESS: -- but I would say the
19 majority of the jurisdictions agree. And it is
20 completely logical because the expenses which cause any
21 loss are not being borne by the consumer. They're not
22 included. The consumer should not expect to get the
23 benefit of a tax deduction for an expense which he does
24 not compensate the company for, if you want to look at
25 it in that fashion. I shouldn't be allowed to take the

1 interest deduction on your house because I'm not paying
2 that interest. But if I'm paying that interest on your
3 house, I should get the deduction within -- I know the
4 IRS has maybe some other restrictions.

5 But that's the simplest -- when we spent
6 \$65 million at Global Solar, that was not in any fashion
7 charged to the consumer. That resulted in a \$30 million
8 tax benefit, round numbers. Should the consumers' rates
9 be reduced by 30 million because the shareholder paid
10 \$65 million and got a deduction? I submit no. That is
11 the height of inequity.

12 COM. MUNDELL: Well, it's certainly an
13 interesting argument that, you know, you actually, the
14 taxes are actually paid, and then at some point in
15 time -- let me back up.

16 THE WITNESS: Sir, that's even a different
17 issue. What you just brought up was timing differences.
18 That's a different issue. And I also agree with the
19 state of the art and what's included in most of the
20 regulations of Congress now, that rates are to be set
21 following deferred accounting so that you don't send
22 wrong signals and make intergenerational inequities in
23 consumers.

24 COM. MUNDELL: Well, I appreciate that, and
25 I think it's important to have it on the record --

1 THE WITNESS: I would --

2 COM. MUNDELL: -- and certainly -- if I
3 could finish, please -- and certainly have some
4 discussion on that. I think counsel for RUCO brought it
5 up and discussed it, and whether or not there's other
6 regulatory methods of determining it. If you're saying
7 that's the one that's universal and it's always been
8 that way, I guess the only question I would ask, going
9 forward we are looking at sort of a different structure,
10 and you are saying no matter whether it's private
11 investors or a public company, it doesn't matter, it
12 should be that way.

13 THE WITNESS: Yes, sir. And don't get me
14 wrong, it's always been that way, because this was a
15 huge fight in the late sixties around the tax reduction
16 act of '65 or '66, and there's a huge fight between Pac
17 Bell, the California Utilities Commission, and the IRS
18 because the IRS or Congress was trying to help generate
19 capital for capital intensive businesses by allowing
20 accelerated depreciation. And the Public Utility
21 Commission in California said, "We're going to take that
22 benefit and we're going to reduce rates with it." And
23 Congress came back and said, "If you reduce rates with
24 it, we're not going to give Pac Bell the deduction
25 because it's being used for an inappropriate purpose, a

1 purpose we did not intend it to." And believe me, the
2 history is replete on that.

3 I'm just saying that at least from the
4 eighties vis-a-vis TEP/UniSource, there has been this
5 stand-alone basis and deferred accounting followed.

6 COM. MUNDELL: Thank you. I don't have any
7 other questions.

8 ALJ RODDA: Okay. Did you have anything
9 more, Commissioner Mayes?

10 COM. MAYES: No.

11

12 EXAMINATION

13

14 Q. (By ALJ RODDA) All right. In lieu of a
15 bathroom break, I just have a really short question.

16 A. That's fine. I'm at your disposal. I will
17 be here as long as you take. I'll just cross my legs
18 here.

19 Q. Yes, me, too.

20 Yesterday when Mr. Rentschler was
21 testifying, he was talking about the board composition,
22 and it appears that the way you envision it that the
23 boards of TEP, UniSource, and UniSource Energy Services,
24 or whatever that holding company over the gas and
25 electric is called, are going to be the same?

1 A. Yes, and UniSource Electric and UniSource
2 Gas.

3 Q. Okay.

4 A. There will be, even though we have a holding
5 company, to maintain proper separation of companies and
6 appropriate ring fencing, we have separate boards, even
7 though they are the same board.

8 Q. Okay.

9 A. The same members, I should say it that way.

10 Q. So my question is currently, I understand
11 the gas and electric boards and the holding company
12 board over the gas and electric are the same, but is
13 that currently different than the TEP board?

14 A. TEP board, we now have a UniSource board,
15 and then we have TEP board which is pretty much all of
16 the UniSource board members, and then UES has a lesser
17 number, but they're all UniSource board members. It
18 just has a lesser number of board members. They aren't
19 all, they aren't all the same, but the ones that are on
20 the board are on the other boards, if I can say it that
21 way.

22 Q. So the UniSource Energy Service board
23 members are a subset of the TEP UniSource board?

24 A. Yes.

25 Q. Okay. And looking at the condition 4.B,

1 are, or B.4 which is related to the service quality,
2 this is the \$1.5 billion --

3 A. Yes, ma'am.

4 Q. -- in the next, until 2008. That is spread,
5 I am sure it's in the testimony somewhere, but that's
6 spread among the three utilities, is that right?

7 A. Yes, sir, yes, ma'am, that was our budget
8 for UniSource Electric, UniSource Gas, and TEP.

9 Q. So based on your budget, you must have
10 separate budgets for each one. Is it broken down, so
11 much is allocated for --

12 A. Oh, I have separate budgets for each one. I
13 don't know how it was presented to Staff, whether it was
14 separate budgets or not. They tell me it's a
15 consolidated budget, the forecast that the parties saw.
16 But we do budget on each individual entity separately.

17 Q. And is my understanding that currently, this
18 proposal about the \$1.5 billion is in lieu of some
19 future proceeding in connection with this proceeding to
20 come up with some service quality standards? You just
21 thought it would be easier?

22 A. It's an attempt to satisfy anybody's concern
23 about service quality. We are very proud of our service
24 quality, we are very highly rated now, we have very good
25 numbers, and these are the numbers, these were the

1 dollar figures that I felt were needed to retain that
2 level of service. So other than a few people in
3 Bullhead City and maybe some carryover from the Citizens
4 transactions, I consider our service exemplary, and I am
5 committed to bringing, if possible, the same level of
6 service to these other communities.

7 I must caution that service reliability in
8 this area is basically driven by storms and drunk
9 drivers. That's what it is: It's electric, it's wind,
10 and it's people hitting poles, and I honestly can't
11 prevent any of those. We can only have as, we can only
12 respond as quickly as possible and try to get our
13 response time down and to do the preliminary, the tests
14 beforehand and the patrolling beforehand to see if we
15 can catch something before it happens in a storm. The
16 1.5 billion is what we, I considered necessary and
17 appropriate to maintain my current service reliability
18 at TEP and improve it at UES.

19 ALJ RODDA: Okay. I don't have anything
20 further.

21 THE WITNESS: If I could, you were asking
22 about board compensation, board composition. You asked
23 a question yesterday about why there were only four at
24 the other one.

25 ALJ RODDA: Someone did, yes.

1 THE WITNESS: That's because we need one
2 independent member on each of the boards for ring
3 fencing. So we didn't want to have five at that level
4 because then we would have to have brought another board
5 member in for the independence. For ring fencing, we
6 need an independent director who has total authorization
7 over filing of bankruptcy, and that's why there's four
8 at the top level and five at the others because we have
9 now that other individual who has the bankruptcy
10 protection, who is not associated with at that point
11 Saguaro Utility Group I.

12 ALJ RODDA: Okay. Thank you. That's good
13 information.

14 Mr. Heyman, did you have any --

15 MR. HEYMAN: No, I would like to get my
16 witness off the stand before he volunteers any more
17 information.

18 ALJ RODDA: All right. Thank you very much.

19 THE WITNESS: Thank you. It's been my
20 pleasure.

21 ALJ RODDA: Thank you everyone for being
22 patient.

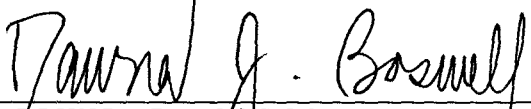
23 We will be in recess until Thursday,
24 July 1st, 10:00 a.m., this room, for Mr. Antonuk.

25 (The proceedings recessed at 1:17 p.m.)

1 STATE OF ARIZONA)
2) ss.
3 COUNTY OF MARICOPA)
4
5
6

7 I, DAWNA J. BOSWELL, Certified Court
8 Reporter No. 50326 for the State of Arizona, do hereby
9 certify that the foregoing printed pages constitute a
10 full, true and accurate transcript of the proceedings
11 had in the foregoing matter, all done to the best of
12 my skill and ability.

13
14 WITNESS my hand this 26th day of June, 2004.

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17 DAWNA J. BOSWELL
18 Certified Court Reporter
19 Certificate No. 50326
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